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VIDEO COMPETITION IN 2005: MORE CONSOLIDATION, OR NEW CHOICES FOR CONSUMERS?

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BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

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VIDEO COMPETITION IN 2005: MORE CONSOLIDATION, OR NEW CHOICES FOR CONSUMERS?

WEDNESDAY, OCTOBER 19, 2005

UNITED STATES SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS, OF THE COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:04 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Mike DeWine, Chairman of the Subcommittee, presiding.

Present: Senators DeWine, Hatch, and Kohl.

OPENING STATEMENT OF HON. MIKE DEWINE, A U.S. SENATOR FROM THE STATE OF OHIO

Chairman DEWINE. Well, good afternoon. We welcome all of you to the Antitrust Subcommittee's hearing entitled "Video Competition in 2005—More Consolidation, or New Choices for Consumers?" Today we will examine two important current issues: first, the purchase of Adelphia by Comcast and Time Warner Cable; and second, entry into the video marketplace by the Bell companies.

These two events push the industry in different directions. There is a consolidation with the loss of Adelphia, with an increase in choices for consumers as overbuilders, Internet companies and the telephone companies roll out video services. These differing market dynamics are representative of the tremendous changes occurring more generally in the entire telecommunications and video marketplace, and these changes have broad, competitive implications which must be explored.

Individually, each event is worth some attention, and accordingly, we will, of course, examine them today. To begin, Comcast and Time Warner Cable proposed to divide up Adelphia's cable operations in various markets around the country. This will make the two largest cable operators in the United States even larger. Many have concerns about this small but potentially significant increase in concentration.

For example, what effect, if any, will this change have on the availability of independent programmers to break into the marketplace? Will the deal give Time Warner and Comcast a greater ability to strike exclusive deals with other programmers, or greater incentive to utilize the so-called "terrestrial exemption" to prevent competitors from gaining access to their programming. These are issues which we intend to explore this afternoon.

While the Adelphia deal gives us some cause for inquiry, there is certainly a significant counterbalance to the questions it raises. As part of this deal, Comcast is giving up its 17 percent stake in Time Warner Cable and its 4 percent stake in Time Warner Entertainment, which will remove a large financial connection between the two competitors. Additionally, this consolidation also likely will lead to efficiencies and a greater ability for these cable companies to improve and expand their competitive offerings.

We look forward today to hearing about how Time Warner plans to use this deal to enhance the experience of its consumers.

Unlike the Adelphia deal, which is in its final stages, the entry of the phone companies into the video business is just in its infancy, but in the long run, this entry likely will foretell a much more significant change in the marketplace. While the phone companies are upgrading their networks and gearing up to enter video overbuilders like RCN are offering much needed competition in a number of communities, which is bringing prices down and providing valuable new services for consumers. We will hear today from RCN, as well as the U.S. Telecom Association, to examine how they view the marketplace.

More generally, we will discuss with all of our witnesses what steps are needed to ensure a competitive future for the rapidly changing world of video and telephone service. As we all know, this marketplace is evolving at an extraordinary pace. The phone companies are beginning to offer video. The cable companies are getting into phone service, and the Internet continues to expand as a medium for all sorts of content. In just a few short years all of these industries may be completely transformed in ways we can only being to imagine here today.

But vibrant competition is not a sure thing. We need to take active steps to make sure that these markets welcome competition and innovation, and that new entry is in fact encouraged. Franchising regulations, access to content and regulatory parity are important issues among many that must be addressed. We have to get it right if we want the market to thrive and provide the maximum choice in value for American consumers.

For those reasons, as we consider the cable and telecommunications laws in the upcoming months, we need to understand whether current regulations are getting in the way of a more competitive market, and if so, then we need to figure out what different rules will help the marketplace create better products for consumers. This is a task that the Antitrust Subcommittee intends to undertake. Our hearing today is a first step toward learning what we need to do to do that. So I hope that all of our witnesses can testify not just about the specifics of the Adelphia deal and of new entry, but also more broadly about how we can help promote competition in these markets.

The Subcommittee, I believe, really has an obligation, an obligation to examine current laws and regulations to make sure that new entrants into video service have a real opportunity to get into these markets, and in fact, to compete. At the same time, of course, we must respect and understand the regulatory burden already placed on incumbent cable providers and take care to ensure that

their long-term efforts and network investments are not unfairly diminished by any changes we make in the legal structure.

In the last 10 years the cable operators collectively have spent approximately $100 billion upgrading their systems and improving their offerings to consumers, all based on the current laws and regulations. We must keep that in mind as we consider modifying the competitive framework that guides the industry.

This is truly a difficult balance to strike, but we must strike it correctly because the reward will be a vigorously competitive marketplace that will ensure the economic vitality of this important sector in our economy. Most importantly, it will help the consumer, and aid in the creation and deployment of new and better products and services for individuals and businesses in our country. Those, of course, are very worthy goals, and merit our strongest efforts.

Let me at this point turn to Senator Kohl, the Ranking Member of this Committee, and my partner who I have worked with so many years on the Committee.

STATEMENT OF HON. HERBERT KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KOHL. I thank you, Mr. Chairman, for holding this hearing today.

As you know, we are at a crucial time for competition in the video industry. The decades-long control by local cable monopolies may finally be shaken by the promised entry of the giant telephone companies into video. But whether we are about to witness the birth of a new world of expanded choices for consumers will depend to a large extent on the policies adopted in the months ahead.

Today's hearing will address several topics crucial to the development of a truly competitive video market. First, what will be the impact for consumers of the acquisition of Adelphia by the Nation's two largest cable competitors? Second, what are the policies we can adopt to ensure that important new competitors in the video market, such as the phone companies, are given a fair shot to compete. And third, how can we assure that independent voices have room to be heard in today's media world?

We continue to witness increased consolidation in the industry. The latest deal is the purchase of Adelphia by Comcast and Time Warner. Once the acquisition is complete, Comcast and Time Warner intend to swap local cable systems to greatly expand their regional presence. This clustering will lead to a very high market share, in several regions of the Nation as high as 70 percent, from the East Coast to California. Such clustering greatly increases the ability of the local cable franchise to gain exclusive rights to "must have" programming, effectively freezing out competitors.

Increasing concentration also makes it much more difficult for independent programmers like our witness from America's Channel to obtain carriage on major cable systems.

Our democracy depends on the ability of independent voices to be heard. We should be deeply concerned when only programmers affiliated with cable companies or the broadcast networks seem to get carried on the cable giants,

There is one significant piece of good news. The entry by the regional Bell companies into the video market. By challenging the

cable monopoly, the efforts by companies like SBC and Verizon creates the exciting prospect of a real new competitive choice for millions of consumers. But we must ensure that undue roadblocks to the entry of the phone companies into video are removed.

Therefore we should consider the following actions:

First a careful review of the Adelphia deal by the Federal Trade Commission and FCC to ensure that it does not lead to excessive market concentration in local geographic markets. Central to this review should be a serious consideration of conditions to ensure that competitors have access to programming that consumers demand, as was done in News/Corp-DirecTV.

Second, closing loopholes in the program access law to ensure that competitors have access to essential programming owned by the cable incumbents.

And third, revising the existing rules so that independent programmers have a fair shot at getting carried.

These and other similar ideas should be on the agenda as Congress looks to rewrite the landmark Telecom Act of 1996. These measures will help assure that consumers see the benefits of increased choice by giving new entrants the breathing room to compete.

We have an outstanding group of me here to offer testimony, answer questions, and I think we are all looking forward to this hearing.

Thank you, Mr. Chairman.

[The prepared statement of Senator Kohl appears as a submission for the record.]

Chairman DEWINE. Senator Kohl, thank you very much.

Senator Hatch.

Senator HATCH. I have no statement I am going to make. I am just very interested in this hearing, interested in hearing from all of the witnesses. I may not be able to stay because of an Intelligence Committee meeting I have to go to, but I am certainly going to pay attention to what you have to say. These are very interesting areas to me, and we will just have to see how we can sift it all out.

But I appreciate our leadership on this Committee.

Chairman DEWINE. I am going to introduce our witnesses. Before I do, let me just say that we really want to have the opportunity to get to questions. We appreciate your being here. We are going to stick very rigidly to the 5-minute rule. So when you see the lights, that is going to be it. So we are going to do 5 minutes because we do want to have time for questions, and we appreciate it.

Glenn Britt is the Chairman and CEO of Time Warner Cable. He has served in that position since August of 2001. He has been with Time Inc. since 1972, and most previously headed Time Warner Cable Ventures.

Kyle McSlarrow is the President and CEO of the National Cable & Telecommunications Association. He is certainly familiar to us here in the U.S. Senate. He has held many positions here in the Senate, including Chief of Staff to the late Paul Coverdell.

Walter McCormick is the President and CEO of U.S. Telecom, a trade association representing the telecommunications industry.

Doron Gorshein is the President and CEO of the America Channel, an independent cable network broadcasting, programming celebrating America. He has also worked at CNN, a channel owned by Time Warner. We welcome him back as well.

Mr. Peter Aquino is the President and CEO of RCN, a cable overbuilder active in several markets. Before joining RCN he served as the Senior Managing Director at Capital Technology Advisers, a telecom restructuring firm.

Mr. Scott Cleland is the CEO of Precursor, a market research firm. He has testified before this Committee several times in the past, and we welcome him back as well.

Mr. Mark Cooper is the Director of Research for the Consumer Federation of America. He has also testified before us on numerous occasions, and we welcome him back as well.

Mr. Britt, we will start with you. Thank you very much.

STATEMENT OF GLENN A. BRITT, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, TIME WARNER CABLE, STAMFORD, CONNECTICUT

Mr. BRITT. Good afternoon, Mr. Chairman and members of the Subcommittee. My name is Glenn Britt, and I am Chairman and CEO of Time Warner Cable. I want to thank you for inviting me to appear here today to discuss Time Warner's role in the remarkable pro-consumer developments occurring in the cable industry.

I respectfully request that my full written statement be included in the record.

Chairman DEWINE. It will be made a part of the record.

Mr. BRITT. Time Warner Cable is the Nation's fourth largest multi-channel video distributor, serving nearly 11 million customers in 27 States. It is an indication of how the competitive landscape has changed in recent years that the two companies immediately ahead of us are not cable operators. They are DirecTV and EchoStar, DBS operators who have used a combination of innovative service and cost effective national marketing to attract over 25 million subscribers.

At Time Warner Cable we have long recognized and responded to the competitive challenges posed by the DBS operators and by others. Our history of innovation dates back to early experiments with interactive television in Columbus, Ohio in the 1970's. Our response to the changing competitive landscape was to invest billions of dollars rebuilding our systems, using an advanced two-way architecture. In fact, since 1996 we have invested more than $17 billion in our infrastructure.

These upgrades allowed us to offer our customers a variety of new video services such as high definition television, digital video recorders and video on demand.

In addition, our investment in upgrading our facilities has allowed us to take on the incumbent telephone companies, first by providing high-speed Internet connections in competition with dial-up service and DSL, and more recently, by offering voice over Internet protocol telephone service.

The response to these new services has been fantastic. We are signing up thousands of new subscribers every week. Most importantly, our success and the success of other cable operators is trig-

gering even more competition. The big telephone companies are rushing to invest billions so they can offer their own bundles of voice, video and data. And that is not all. Power companies and wireless providers are also innovating and investing, promising more competition in the days ahead.

At Time Warner Cable we view this competition as creating new opportunities for consumers and for independent creators of innovative and attractive services and content. Our goal is to bring as many of these services to as many consumers as possible.

As you know, Time Warner Cable recently entered into an agreement, together with Comcast, to purchase cable systems from Adelphia, which has been in bankruptcy for more than 2 years. The Adelphia systems, not surprisingly, lag behind in the deployment and marketing of advanced services. The proposed transaction will allow us to bring advanced services such as VoIP to millions of new customers, including more than half a million customers in Ohio.

We are also continuing our existing strategy of regional clustering by swapping certain systems with Comcast. AS the FCC has recognized, regional clustering creates cost savings efficiencies and economies of scale that enhance competition and promote innovation.

It is not surprising that some of our competitors would like to impose new restrictions on our clusters, but even with the proposed transactions, Time Warner Cable's regional footprints will be dwarfed by the national reach of DBS and by the contiguous multistate territories of the incumbent telephone companies.

We believe that the new super-competitive landscape requires a new way of thinking about regulation. And the foundations for that debate should be that like services are treated alike and that Government should not play favorites among competitors. If those principles are followed, we are confident, and you can be confident, that the clear winner will be the American public.

[The prepared statement of Mr. Britt appears as a submission for the record.]

Chairman DEWINE. Thank you very much.

Mr. McSlarrow.

STATEMENT OF KYLE MCSLARROW, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION, WASHINGTON, D.C.

Mr. MCSLARROW. Mr. Chairman, thank you very much for inviting me here. With your permission, I will submit my full testimony for the record, and just make a couple of observations.

My testimony is really a continuation of the conversation that you and Senator Kohl and I have already had. We are focused on video competition, quite properly, but the truth is, if you go by the statements that each of you made and that all of us will be talking about, this is part of a bigger picture which is really about broadband and competition in America. Video is a hugely important piece of that, but it is just one piece.

Mr. Britt just now mentioned the idea that as Congress takes a fresh look at the Telecommunications Act, it is important that we keep a couple of principles in mind. One is, as he mentioned, treating like services alike. We would also add that when we think

about video competition, we should think more broadly about not just a level playing field for all competitors, but what is it we want in the future, 5 years, 10 years down the road? I would submit the kinds of questions that we have been asking over the past 5 years, maybe even last year, are already becoming stale this year.

Things are happening so fast. There is so much dynamism in the telecommunications industry. We have already mentioned the telephone companies getting into video. We have the spectacular success of two satellite providers with national footprints. We have all kinds of content owners figuring a million different ways to get video and other forms of content into the hands of consumers, whether it is through pipes into the home, or mobile devices, or the Internet.

So this is a great time to step back and think about, No. 1, what are the problems we are trying to solve, and number two, how do we keep the kind of investment and innovation that has been flourishing over the last couple of years—as well as competition—going?

One additional point, even though it may not squarely fit within this topic: if you are thinking more broadly about video competition, we have to think about the kinds of investments that I would suspect you want to encourage and that the cable industry, for one, has been focused on making. We have spent close to $100 billion over the last 10 years, partly because we made an agreement with Congress that if we were deregulated, we would build out our plant with fiberoptic technology. We would deliver all these two-way services in video and voice and data.

I think because of that success, there is an opportunity and probably a risk that others will want to take advantage of the kinds of investments that other people have made. I will give you one example. Right now before Congress is the issue of the digital transition. While that bill is going to be marked up in another committee, one of the issues that has come up is called multicasting, which is the broadcasters' claim for mandatory carriage—in addition to the mandatory carriage they already have—of up to six channels of our capacity.

One reason why I say we cannot just focus on video is that the pipe we provide into the home is a broadband pipe. We do not just do video. So if somebody comes along and takes our bandwidth—which we would submit is properly within your jurisdiction as the taking of private property—then you are not just hurting other independent voices, as you said Senator Kohl, who might be out there wanting carriage on our pipe, you are also hurting our ability to deploy other broadband services.

So I think this hearing is timely. I know that you are going to be doing others down the road. We welcome and would be delighted to participate in that process, and we thank you for having the hearing.

[The prepared statement of Mr. McSlarrow appears as a submission for the record.]

Chairman DEWINE. Thank you very much.

Mr. McCormick?

STATEMENT OF WALTER B. MCCORMICK, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNITED STATES TELECOM ASSOCIATION, WASHINGTON, D.C.

Mr. McCORMICK. Thank you very much. I too would ask that my full statement be included in the record.

Mr. Chairman, our membership ranges from the smallest rural telecom companies to some of the largest corporations in America, and we are united in a single belief, that it is time to update the Nation's telecommunications laws to reflect the dramatic technological and marketplace changes that are taking place today.

As the Subcommittee examines the state of video competition, let me highlight three aspects that we believe are worthy of examination. First, broadband deployment. As my colleague Kyle McSlarrow said, broadband deployment is critical, and video is going to play a significant role in the widespread deployment of advanced broadband technology. It is video services that local telecom companies will deploy over the new broadband networks that will drive subscriber growth and thus network deployment.

For example, SBC Communications is planning to offer services with interactive features that go far beyond those provided with video programming today. Verizon Communications has already started deploying fiber optics to the home with the intent of offering subscribers new and innovative video offerings. And across this Nation there are scores of small,independent, local telecom companies that are investing in new infrastructure to deliver video choice and innovative services to consumers.

Second, price. Mr. Chairman, I should not have to convince this Subcommittee that competition is a good thing and a check on inflation. There are few areas where there is greater price inflation than in the delivery of cable television services. According to the GAO, even with the presence of two satellite competitors, cable operators have been increasing their prices at a rate that is nearly three times the rate of the consumer price index. This hurts every consumer, but especially the economically disadvantaged and those living on fixed incomes. Indeed, in Keller, Texas the local cable operator has responded to Verizon's entry by dropping its price by 50 percent.

Third. We urge this Subcommittee to consider the effect of unnecessary governmental barriers to competitive entry. The current franchising process imposes substantial delay in transaction costs, and thereby, the uncertainty raises the cost of capital. Some U.S. telecom companies are reporting that it is taking as long as 3 years to get franchises. And aggressive cable opposition to the granting of competitive franchises in local area suggests that the cable industry itself sees the franchising process as a barrier to entry that it will use to insulate itself from competition for as long as possible.

Build-out requirements are another barrier to entry. Indeed, the very notion of imposing build-out requirements on competitors is virtually unheard of in our country, and the same cable operators who argue for build-out requirements on our industry, vigorously oppose any requirement that they build out to match telephone service territories when they offer voice telephone service. Build-out requirements do not protect consumers. In small communities like Lakedale, Minnesota, companies have invested to build out in-

frastructure to offer voice video and Internet access. At the petition of the local cable operators, these companies have been told they cannot offer video over these facilities unless it is built out beyond the voice network to match the cable footprint.

So we have areas where facilities have been deployed and consumers are being denied the service simply because it is now economically impracticable to do so.

We are seeing this use of governmental processes by the cable industry to slow competitive entry, everywhere. Cable operators in Texas have sought to enjoin the newly enacted State franchise law. And this is not just aimed at stopping entry by large companies like Verizon and SBC, it is aimed at small entrepreneurs as well. In Texas, the first certificate granted under the new law was to Guadalupe Valley Telephone Cooperative, which is a small company seeking to compete with one of the Nation's largest cable operators.

So in conclusion, Mr. Chairman, we believe it is time to update the laws. Rapid advancements have eliminated technological barriers to entry. We believe it is time to eliminate the regulatory barriers into entry into video competition as well.

Thank you again so much.

[The prepared statement of Mr. McCormick appears as a submission for the record.]

Chairman DEWINE. Thank you very much.

Mr. Gorshein, thank you for coming.

STATEMENT OF DORON GORSHEIN, CHIEF EXECUTIVE OFFICER, THE AMERICA CHANNEL, LLC, HEATHROW, FLORIDA

Mr. GORSHEIN. Mr. Chairman, members of the Subcommittee, thank you for the opportunity to testify today on behalf of the America Channel. I am here to share our perspective on the state of competition in the video space based on our experiences as an independent channel seeking access to the consumer.

The America Channel is a nonfiction programming network, set to explore and celebrate America, profiling its diverse communities, local heroes, ordinary people who accomplish the extraordinary. It is not a channel about celebrities or the latest fashion, but about the every day heroics and stories of real political, their struggles, aspirations and achievements.

The America Channel was founded in the months following 9/11 when television no longer resonated with my sensibilities as an American consumer. Indeed, our stellar market research results confirmed that many Americans share this view. We discovered that Americans want more relevant programming, more programming about what makes America special, more community, more connectivity and more authenticity on television. This is why we believe the America Channel could be the most powerful, most resonant new product to come along in quite some time.

We then spent 18 months and a million dollars from investors on planning, development, market research before approaching the cable operators. As part of our efforts, I traveled to dozens of cable systems across America which are owned by the top cable operators. The reception was overwhelmingly positive. We believe our level of diligence was a strong as any new channel's.

The key to viability is distribution to a sufficient number of households and access to certain key markets. Because of the market power of the largest cable operators, access through them is absolutely essential. If they say no, the viability of a new channel is in peril. Today the America Channel has distribution relationships with the majority, the vast majority of what will become the telco video space, including Verizon, SBC and others, and productive discussions with both satellite players.

But after nearly 2½ years we have had virtually no progress getting carriage from the dominant cable operators. Why is this? One reason is the cable operators are vertically integrated. They own channels. The telcos do not. This is relevant because an independent channel is a direct competitor to a cable-affiliated channel on several fronts, for viewers, ad dollars, technical capacity, and the asset value is independently owned. New independent channels, typically free to the cable operator for several years, also create downward pricing pressure on affiliated channels. A review of Kagan's Reports reveals the average fee for a cable-affiliated net is more than three times the fee for the few independents.

One major cable operator derives 40 percent of its operating income from its television networks, only 28.6 percent from cable subscriptions. That operator has strong incentive to exclude the less expensive and better products to protect increased rates for its own channels.

A fully distributed channel is typically valued in the billions of dollars and generates annual revenue in the hundreds of millions. Thus, vertically integrated cable operators must choose between owning 5 percent of the revenue and asset value when launching an independent channel, versus 100 percent when wholly owned. It is an easy decision and an inherent conflict of interest that prevents the best value products from reaching the market.

The GAO confirmed that cable operators are much more likely to carry affiliated networks over independents, and we found that each of the top two cable operators over a 2½ year period, carried on a non-premium wide basis only one of 114 channels with no media affiliation. Meanwhile, most affiliated channels are carried.

John Malone recently said that an independent channel has no chance whatsoever if Comcast does not carry it, and Cable World Magazine reported that VC funding of entrepreneurial cable networks has died because of the gatekeeping power of the top cable operators.

Of the 92 channels that have reached the critical viability threshold of 20 million homes, not a single one did so without at least two of Comcast, Time Warner and Adelphia. The Adelphia transaction, with its geographic rationalization, if consummated without conditions, could mean the end of new independent channels. Though we believe the public would embrace the America Channel, this hearing is not about any single product, it is about free competition for content and for services. We believe the telcos, in contrast to the largest cable operators, are squarely focused on free market competition with better channel selection, lower price and higher quality customer service. Their success is critically important, and they should be helped to deploy their services and have fair access to content.

Foreclosure of opportunities for independent channels has adverse effect on competition, consumer choice, consumer pricing, and the diversity of ideas in the marketplace. We must have an environment which permits free competition on the merits. It is my hope that our experience will help you address these systemic problems that play out to the detriment of all Americans.

Thank you.

[The prepared statement of Mr. Gorshein appears as a submission for the record.]

Chairman DEWINE. Thank you.

Mr. Aquino.

STATEMENT OF PETER D. AQUINO, PRESIDENT AND CHIEF EXECUTIVE OFFICER, RCN CORPORATION, HERNDON, VIRGINIA

Mr. AQUINO. Good afternoon, Mr. Chairman, Senators Kohl and Hatch. My name is Peter Aquino, and I am the CEO and President of RCN Corporation.

RCN is a leader in facilities based broadband expansion in the United States. We bring voice, data and video to consumers through the triple play, since 1997, and before any of the other incumbents had embarked on the triple play. Now, we are asking you to help us to ensure a marketplace in which there is more consumer choice and one that fosters additional broadband expansion. Ensuring access to programming with fair rates is key.

To allow us to expand our pro-competitive presence, we are asking you today to do the following.

1. To ensure that the FCC and FTC condition the Adelphia transactions to require that competitors have access to programming at rates and on terms equivalent to what Comcast and Time Warner charges themselves.
2. Request that the FTC immediately open an investigation into the rates and terms for video programming in general, to illuminate the current discriminatory pricing structure that favors large cable operators, and to debunk the myth that these discriminatory rates are justified.
3. Close the terrestrial loophole in the program access rules. I think that is very important.

And then finally, reject the former Bells' demand that franchise relief is necessary. In a fair, open and competitive marketplace with fair price structures, we can provide cable choice to even more consumes, and I hope you support this goal.

I took the helm at RCN last year, and RCN today has more than 850,000 customer connections on the East Coast from D.C. to Boston, Chicago and some parts of California. Our current network passes about 1.4 million homes, and we have 6 million homes licensed. We do this with 130 franchise licenses and that is without any special concessions.

I am especially proud of the fact that RCN's presence in the marketplace has produced documented benefits for consumers. As both the FCC and GAO have reported, this includes more choice, telecom infrastructure upgrades, better customer service, and a check on ever-rising cable rates. With fair practices and price structures we can do even more. We can expand competition and give

consumers a choice, provided we have access to "must have" programming with rates that are fair.

Comcast and Time Warner's proposal to acquire Adelphia and swap systems among themselves threatens our ability to access programming on a fair basis. A major concern with the Adelphia transactions is that these companies, which will control over 47 percent of the market, are swapping system to consolidate regional clusters. The FCC has said that clustering will increase the incentive of cable operators to practice anticompetitive foreclosures of access to vertically integrated programming. At a minimum, conditions similar to those imposed on News/Corp's acquisition of DirecTV should be applied to the Adelphia transaction. These conditions would ensure access to vertically integrated programming with fair rates and terms, and would give us an arbitration process if disputes arise.

We do not oppose the Adelphia merger, but this kind of market concentration is supportable only if pro-competitive conditions are imposed.

Comcast also has a history of using the terrestrial loophole to foreclose competitors' access to regional sports, a "must have" content. So this loophole needs to be closed.

Although we currently have access to programming, companies like RCN are being placed at a significant price disadvantage. We brought a chart today, a chart that shows that we believe our programming costs as a competitor are double those of large cable companies. Roughly 32 percent of our programming dollars currently go to Comcast and Time Warner and their affiliates. As their control over "must have" sports and other programming grows, so does their ability to charge even more excessive rates.

We believe an FTC investigation into discrimination in video programming rates and terms would both illuminate the problem and make clear the need for legislation to provide fair access.

RCN is very innovative and we are broadband fiber leaders, and we want to be part of the continued broadband expansion in the United States.

I thank you for this opportunity to speak today.

[The prepared statement of Mr. Aquino appears as a submission for the record.]

Chairman DEWINE. Mr. Aquino, Thank you very much.

Mr. Cleland.

STATEMENT OF SCOTT CLELAND, FOUNDER AND CHIEF EXECUTIVE OFFICER, PRECURSOR, WASHINGTON, D.C.

Mr. CLELAND. Thank you for the opportunity to testify, and I also request to have my full testimony in the record.

Chairman DEWINE. It will be made part of the record.

Mr. CLELAND. I want to commend Congress. In both the 1992 Act and in the 1996 Act, there was vision and there was great success. I think that both video and telecom competition is increasingly vibrant and I think it is here to stay. I do not see it being reversed. I think the facts are clear that cable is no longer a monopoly.

There are now 28 million Americans, or 30 percent of the market where they have taken their freedom that Congress gave them and

they can tell their cable company to take a hike if they do not like the service or the offering at the price they are getting.

And the cable industry has spent $90 billion to basically compete more aggressively, and so the marketplace is working. It now has the best plan and offering some of the better services in the marketplace.

The other thing that is good is telecom and cable competition is finally happening. The cable industry is a good two to 3 years ahead of the telephone industry in entering the other's business, and I think that what you are going to see is you have seen a couple million cable customers take telephony from cable companies this year. It is going to be several million next year.

And at that same time we expect, if there are a million or two that take video from the telephone companies, that will be a surprise. So for the next two to 3 years you are going to see the numbers, because cable got its act together two to three to 4 years earlier, that they are going to be taking millions of customers from the Bells before the Bells are taking millions of customers from them.

To just give you a little bit of insight, I think that Verizon is probably the most serious and quick about getting into video. I think SBC is the least serious. I would think that Bell South is very well prepared and is kind of under the radar, and I think Qwest really can only afford DBS resale.

So briefly on the Adelphia transaction, I also do not see that as a competitive problem. In a sense there are two big things that transaction accomplishes. In 2002 the Department of Justice ordered that these two companies, Time Warner and Comcast, has to divest the cross-ownership between the two. This transaction accomplishes that and that was not easy to accomplish. The second thing it does it that it brings 5 million American consumers under reputable and competent management. Those 5 million customers were operated by a criminal family enterprise, and this is a good development, getting these 5 million subscribers under competent management so that they can have better service.

Now, Mr. Chairman, in the last couple minutes you asked in an opening statement for ideas of how to better promote more competition. Well, last April when I testified before the Committee I said the Bell mergers were not a problem, but I said there was a looming problem out there that I warned the Subcommittee about, and that was bitter interference.

Well, 2 weeks ago something big happened. And that was a denial of access, which is what I was arguing, is the big fear to competition in the Internet. What happened is Level 3 went to Cogent, one of the providers, and basically denied access. And so about 5 percent of the Internet went dark for a couple of days about 2 weeks ago. Precursor was one of the companies that got turned off. We were not able to fully publish. We were not able to do our research, and many of our colleagues that had had voice over IP were not able to complete their phone calls.

How this happened was a big company went to a small company and said, "You are not paying us enough in this peering arrangement." The Internet is built on cooperation. The fabric of cooperation has been very strong to date, but what I want to point out here is if the big feel that they can take the small hostage by basi-

cally saying, “If you do not pay us more money to transit, we will cut you off—heck with the consumers and the businesses that are relying on the Internet to do interstate commerce.” That is what happened.

So what I want to advise the Committee here is this is a case where an ounce of prevention can prevent a pound of cure, is the Internet functions exceptionally well right now in a cooperative way. I am by no means calling for a regulation. That would be a disaster. What I am advising is do something now so you will not have to regulate later. My advice is that the Committee and the FCC and everybody in Government should say, “Look, if you have disputes on peering arrangements, these should be handled by private sector commercial arbitration disputes, but they should never devolve down to the level of cutting off people from the Internet.” And so it is in everybody’s interest for the Internet to be free and competitive.

And so I just flag that issue. It will get worse if the Government does not flag it. Thank you.

[The prepared statement of Mr. Cleland appears as a submission for the record.]

Chairman DeWine. Very good.

Dr. Cooper.

STATEMENT OF MARK COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA, WASHINGTON, D.C.

Mr. Cooper. Thank you, Mr. Chairman, Senator Kohl. My testimony outlines our concerns about the Adelphia merger transaction, and I want to focus on the second issue that you raised. A number of the other people have expressed similar concerns that we had. I want to focus on it, and I am going to do it in terms I think the Antitrust Committee it is relevant to.

I certainly applaud the potential for the arrival of a new cable competitor that will end this persistent monopoly, but I must remind you that policymakers have been promising consumers cable competition for 20 years, and it never seems to quite get here. It is always someplace around the corner, and when it arrives, it is expensive bundles, it is very, very inconsistent, infrequent and does not serve the interest of the average lunch-bucket cable consumer. We never got the second wire. Satellite has not disciplined. Video dial tone disappeared. And so now they tell us, you tell us the telephone companies are coming to help us. I remind you that they have a miserable track record in both opening their own networks and entering other service areas as a competitor.

As a result, cable consumers have been forced to buy huge bundles of packages in which they do not watch three-quarters of the programs they are forced to pay for. Cable ties the tiers together, so if you want to buy the second tier, you have to buy the first tier. The only exception is a Congressionally mandated one. They then bundle at each tier. They tie high-speed Internet to basic video service with a negative $15 price on basic service. That is a predatory price. They then force consumers to buy their Internet service provider. It is a tie. And if you want to get your own service provider, you have to pay for two, pay twice.

Telcos do essentially the same thing. Most refuse to sell standalone DSL service separate from their franchise product, voice. They are offering even bigger bundles for consumers, not more choice, just take it or leave it, all or nothing. Now, that is a choice, but it is not the choice consumers want. It is not real consumers' choice of picking the programs they want to pay for.

The average monthly bill for cable service has doubled since the passage of the '96 Act, doubled the average monthly bill. It has been pointed out that there is only one other commodity dominated by a foreign cartel and a domestic oligopoly that matches that, and that is gasoline.

Entry by the telephone companies into cable will not serve the consumer if they insist on bundles, if they do not open their networks, and of course, the price they want to impose is the complete abandonment of public policy and public interest obligations on their service territories. The build-out requirement there again means that they are not going to serve the poor people they promised to help and who their big bundles will not in fact do any good for.

Of course, cable entry into voice will not do nearly as much good as it could if they can tie it together with their other products, if they can foreclose their network from competing service providers, which they can, in fact, are likely to do.

So what are the big issues that this Committee needs to address and can address pro-competitively on an antitrust set of issues. One, Mr. Cleland has suggested the first one. You cannot interfere with the bids. Nondiscriminatory access to the means of communication have been a fundamental part of our society since its founding. Roads were open to all, canals were open to all, steamship lines, et cetera, have all been open. We have to preserve that principle of network neutrality.

It has to be enforceable. The FCC had a charade of saying, it is a principle, we adopt it, but it is not enforceable. You cannot as policymakers accept that.

Second of all, if you really want competition, then we have to have more last miles, and the way to get that, someone else mentioned, the DTV transition. We need unlicensed spectrum available for platforms to reach consumers in the lower bands so that we are not dependent upon centralized investments by a little duopoly or even a triopoly.

Third, we need municipal broadband to be open. Congress said in the '96 Act any entity should be allowed to compete. Unfortunately, even a simple word like "entity" confused the court.

So they have been eliminating municipalities from providing competition. That is a barrier to competition. That is something I think is within the purview of this Committee to look at. And so we need to make sure that any entity has access to the public, cannot be cutoff from access to the Internet, and that will create a playing field where multiple platforms can compete for the consumer's dollar.

Thank you.

[The prepared statement of Mr. Cooper appears as a submission for the record.]

Chairman DEWINE. Good. Thank you very much. We appreciate all your testimony.

Mr. Britt, we will start with you. You are first. I live in Ada, Ohio, and I currently have Adelphia service. What is going to change for me? Will I still be able to walk across the street and sign up for service, or am I going to have to call some number and wait and punch in some numbers and do some things? Am I going to have to do that? Or am I going to get more cable choices, more channels? What is going to happen to my price? That is what people want to know, and it is not, of course, obviously, just Ada, Ohio. It is Chillicothe, it is Newark, it is Bryan, it is Cleveland. It is, you know, 800,000 customers, I guess, in Ohio.

Mr. BRITT. Thank you, Mr. Chairman.

Chairman DEWINE. I used to live in Ada, Ohio.

Mr. BRITT. A few things will happen, I think all of them good.

First of all, because Adelphia has been bankrupt, it has not been able to invest in upgrading its cable systems in much of its footprint. We are going to invest a great deal of capital so that the infrastructure can handle new services. We will then offer all the same services we have been offering on Time Warner Cable, services like broadband, voice over IP, high-definition TV, et cetera.

We believe, to answer one of your questions, that this is a local business, so although we are very large company, we operate it as a local business. We provide customer service locally. Our employees live locally. We are part of the communities that we do business in. We do not believe in centralizing these things from very far away.

So I think what the consumers will see is more services, better customer service, and local service.

Chairman DEWINE. When would people start to expect, though, to see kind of a change in the menu or a change in the options?

Mr. BRITT. Well, first, of course, we have to close our transaction—

Chairman DEWINE. Well, I understand. I mean assuming—you know, once the curtain comes down.

Mr. BRITT. Once it is closed, the answer will vary location by location. Some places that are more easily upgraded will get the new services very quickly. Others need to have the construction process of upgrading them, so that will take a longer time period. And I do not have a complete answer, but I would say in a couple of years, everybody will have all the services.

Chairman DEWINE. A couple years?

Mr. BRITT. Yes.

Chairman DEWINE. So it would be fairly uniform then at that point?

Mr. BRITT. Yes, as the Time Warner footprint is today.

Chairman DEWINE. Let me follow that up with another question. The Bell entrants—and Mr. McCormick argued that it is unfair to place the same regulations on phone companies in the video market as are placed on the cable incumbents, because in the video market the Bell Companies are new entrants with no market power, no market share.

They also point out that when the cable companies offer telephone service as a new entrant, they are not forced to abide by all

of the requirements and restrictions placed on the phone incumbents.

Do you disagree with that, and why?

Mr. BRITT. First of all, when we enter the phone business, we have been going to PUCs and getting licenses. We have been submitting to all of the regulation that is applicable to CLECs, including things like paying into universal service, CALEA, 911, those sorts of things. So I am not quite sure what he is talking about.

I think everybody has anecdotes of the other side trying to thwart them through regulation. We in our own case, in my written testimony, talked about experiences we have in South Carolina where some of the rural phone companies are trying to keep us out and have gotten the PUC to vote against us. So that is applicable to both of us.

I think the larger question is what sort of regulation should we have for this industry, this converged industry. It is not just video. It is video, broadband, and telephone. What sort of regulation do we want for the long run? What is the role of the local municipality? What is the role of the State? What is the role of the Federal Government? And, really, that is the question.

I do not believe that the franchise process is creating a meaningful impediment to the phone companies. Verizon is getting lots of franchises. Most cities are eager for competition. They are not interested in delaying competition.

Chairman DEWINE. Let me go back to the first question that I asked Mr. Britt and see, Mr. Aquino or Dr. Cooper, if you have any comments on that.

Mr. AQUINO. I do agree with—

Chairman DEWINE. My friends in Ada or Cleveland or any place else in the system, what are they going to see different? Do you agree with his answer?

Mr. AQUINO. I agree with Mr. Britt, first of all, on the franchise side. We have gotten a lot of franchises—

Chairman DEWINE. OK. You want to take that one then. OK.

Mr. AQUINO. I will take that one first.

Chairman DEWINE. All right. Go ahead.

Mr. AQUINO. The answer to your other question about, you know, upgrading Adelphia's network, I also agree with Mr. Britt. A system that is not taken care of for a long time requires fiber upgrade in order to offer voice services and high-speed data services. And certainly Time Warner and Comcast are well equipped to make that upgrade and ultimately bring consumers the choice of the triple play or products, you know, whether it is voice, data, or video.

And when it comes to franchising, I would just reiterate that it is just not an impediment. As an entrepreneurial company, we haven't really had a big problem to get franchises.

Chairman DEWINE. Dr. Cooper?

Mr. COOPER. This is an interesting case, and it frequently happens that the real bad guy is not in the room here in the sense that the creation of regional clusters, which is a really serious problem, is the other party to the merger; that is, Comcast has now created a tremendous set of clusters in a lot of larger markets. That is a great concern to us, as we outlined in our testimony. And so it is

all those swaps that were around the rest of the transaction, that is a grave concern.

Time Warner is also the smaller of the acquiring parties, so their footprint as a national actor is smaller.

The simple answer is that a simple transfer of ownership of systems in Ohio from one party to another, divorced from the question of the regional clusters, divorced from the question of a national footprint, is not a bad thing for consumers, especially when, as was pointed out, it was run as a criminal enterprise.

So I don't disagree with his statement as far as it went. It is all the other stuff that he is not the primary moving party to that is the source of our concern about this merger in terms of regional clusters and national footprint.

Chairman DEWINE. OK. Mr. Cleland?

Mr. CLELAND. Thank you, Mr. Chairman. Just real briefly on clusters, I have to disagree with Dr. Cooper on the fact that clusters—the cable industry was very fragmented, and clusters give you enormous efficiencies. Those efficiencies have been handed back to consumers by getting better plant, getting high-speed access faster, getting more services faster. And so clustering, they are not anywhere near as clustered as regional Bell Operating Companies are. And so clustering is not by itself an evil. It is a benefit that has redounded to great benefit of consumers.

Chairman DEWINE. OK. Who else wants to jump in? Mr. McCormick?

Mr. MCCORMICK. Mr. Chairman, I would like to respond to a couple of the comments that have been made.

First, with regard to the franchise requirement, Verizon has been at this for a year. It has obtained 14 franchises out of the more than 10,000 franchise areas that its region covers. If it gets one a day, it will take about 40 years for Verizon to achieve franchise agreements in all those franchise areas.

Second, with regard to the cable industry's entry into video, I would like to submit for the record a list of a dozen key telephone industry regulatory requirements that are unapplicable to the cable industry when it provides voice services, but, most important is the build-out requirement. In no area has the cable industry been required to build out to match the telephone service area prior to its offering voice service to its customers. And one of the biggest impediments to our deployment is that the telephone service footprint does not often match the cable franchise, and yet we are being prevented from being able to offer video to our customers.

In Ohio, we have 32 companies that are offering telephone service, and some of the most innovative companies in the country are moving into video: Horizon, Champaign Telephone Company, and SBC.

Finally, SBC's commitment. SBC is very serious about deploying video. Its commitment is to have 18 million customers, 50-percent penetration, within 3 years. For purposes of comparison, it took the cable industry 35 years to reach a 50-percent penetration. It took Internet service 9 years. SBC is investing billions of dollars today to reach a 50-percent penetration in its region within 3 years.

Chairman DEWINE. Senator Kohl?

Senator KOHL. Thank you very much, Mr. Chairman. I would like to ask permission to insert the statements of Senators Leahy and Feingold into the record.

Chairman DEWINE. Without objection.

Senator KOHL. Mr. Britt, I would like to ask you a couple questions about the Adelphia deal. As part of this transaction, Time Warner and Comcast, as you know, intend to divide up Adelphia and then swap local systems to increase their regional clusters. As a result, local market shares will go up significantly in many communities to as high as 70 percent in some.

Mr. Britt, do competitors have to worry about what you or Comcast will do once you gain such high local market shares and also that you will be able to lock up "must have" programming, like regional sports programming? And will you then—or should they worry that you will then deny that programming to your competitors?

Mr. BRITT. Senator, on the question—the first question was really about clustering, and I think as somebody pointed out earlier, our big competitors are better clustered than we will be even after this transaction. So we have two satellite companies, who are both larger than we are, who have national footprints. So that is about as well clustered as you can be. And then we are competing against these very large multi-State phone companies that have much larger contiguous clusters than we have. So we are not quite sure we see what the issue is.

We do understand—the question of program access has been brought up, and I think there is vigorous competition in this marketplace. We are in general, Time Warner, not an owner of regional sports networks, which seems to be the big focus. We are going to be a minority owner in a new Mets sports network in New York. That will be available to anybody.

Actually, the irony of this to me is that the single economically largest example of exclusivity in sports is the NFL DirecTV package, the Sunday Ticket package, which is exclusive and has been unavailable to any other multi-channel video operator other than DirecTV. So I am not quite sure what the issue is in relation to clustering.

Senator KOHL. Well, Mr. Aquino, what is your opinion? Does the Adelphia deal heighten your concerns about gaining access to programming?

Mr. AQUINO. I think the Mets is probably a good example. It is access to programming at affordable rates. I used to pay a certain rate when the Mets were part of the MSG Network. To go to a Comcast/Time Warner venture, my rate increase will be about 20 to 25 percent as they strip it out of one package and create another company. That type of programming access is really the problem that we are going to face as entrepreneurs, that the price is getting out of control. We certainly don't want to pass those types of rate increases on to consumers. There is a certain market rate in the marketplace that is acceptable, but when programming, regional sports in particular, begins to fall into only a few hands, those are "must have" programs. And with those rate increases, that is just unattainable.

So that is my main concern with the clustering.

Mr. BRITT. Senator Kohl, if I could just respond?

Senator KOHL. Go ahead, Mr. Britt.

Mr. BRITT. In the case of the Mets network, the owners of the Mets were going to form that network whether we invested in it or not. We were very small investors. So we, unfortunately, are sharing the cost increase that RCN has, and I would say that the cost of sports programming is a big issue for all of us. It is unrelated to the structure of the cable operator business.

Senator KOHL. What about you, Dr. Cooper? Do you believe that we do, in fact, have reason to worry about this deal, that it will enhance Time Warner's and Comcast's ability to lock up programming and deny it to their competitors?

Mr. COOPER. Again, the important guy is not in the room, the one that controls the sports, that has withheld it from competitors, that invented the terrestrial loophole, so to speak, and saw it as a point of leverage. And that is the fundamental difference between the so-called clusters of the Bells and the clusters of the cable systems. The Bells could not leverage their cluster. They were subject to regulation and non-discrimination, and so it did not do them any good to have that cluster because they could not discriminate in access to their systems.

Now, of course, as we go forward into the new broadband era where the Commissioners decided that they are not longer obligated to provide access to the networks, they may change that. But that is not the direction we should be going.

So there are clear examples of sports programming that has been withheld through the terrestrial loophole. Those clusters are the leverage for it. If you live in Philadelphia and you cannot see the Phillies or the Sixers, what do you need somebody else for? You want that stuff, and that drives penetration, and that can be withheld. Closing the terrestrial loophole is one of the clearly competitive issues that this Committee can address.

Senator KOHL. Mr. Cleland?

Mr. CLELAND. Yes, I would just like to add, you know, we have two different choices, and I think we chose a market-based solution in going forward with cable. And markets don't always provide for all consumer wants. There are some consumer wants that don't necessarily make economic sense, and so my point here is there are all sorts of instances where a marketplace delivers things consumers don't like.

When I am on an airplane, I cannot get Coke. I can only get Pepsi products. That is because the marketplace has set up a regime where it makes sense to have a sole-source supplier and they pay for it.

Now, is that something regulation is necessary? I don't think so. And so there are going to be lots of times in programming where consumers may not get all they want or may not get the best deal they want; however, the alternative of Government intervening and being the chooser rather than the marketplace I think is much, much worse. So it is the lesser of two evils.

Senator KOHL. Mr. McSlarrow or Mr. Gorshein?

Mr. MCSLARROW. I am here representing the cable industry, but because a couple of assertions have been made about Comcast—

even though I am not representing them specifically—I feel compelled to jump in here.

First, it is false that Comcast Sports Net has done something with the so-called terrestrial loophole. What Comcast did in Philadelphia was acquire from Prism an existing microwave terrestrial distribution system, which had some sports programming on it, and they brought new sports programming to it. Sports Net is local in Philadelphia, and Comcast did not change what they had acquired. In every other instance, including here in D.C., Comcast Sports Net is satellite-distributed and is available to all other distributors.

There is no such thing as the terrestrial loophole. That is a misnomer. The policy in the United States is that programming decisions should be left to the marketplace between programmers and distributors. There is an exception carved out for, I think, sound policy reasons. It says that where you have vertically integrated programming with distributors, you need to ensure that they are not discriminating against other distributors. And the Congress has defined that as satellite-distributed networks. The FCC many times has looked at this issue and agreed that for very good policy reasons, you want to encourage terrestrial networks that can give you the kind of local and regional news and other local programming that you wouldn't otherwise have an incentive to invest in.

Senator KOHL. Mr. Gorshein?

Mr. GORSHEIN. Thank you. Just a couple of quick things from a clustering perspective. I heard the term "national clustering" earlier, but I think it is also important to look at the top DMAs in the country. And post-transaction, 38 out of the top 40 markets will be locked up or substantially controlled.

Now, from my limited perspective as an independent programmer, what that means is that although other regions of the country may be available theoretically, I will be foreclosed from competing because the investment community, the advertising community will say, well, you don't have the top markets or most of the top markets or some of the top markets, and, therefore, you are not viable because the top markets are where disposable incomes are higher, product trends get set, and there is the presence of major press.

One other point. Empirically, we looked at, on the ground, what the top 92 channels have done. These are the channels that are in 20 million homes or more. Twenty million is a key number, as everyone in the industry knows, because that is where Nielsen ratings are accurate and reliable and where, for most networks, profitability starts. Ninety out of the 92 secured carriage from both Comcast and Time Warner, two from one of Comcast or Time Warner, but those two also secured Adelphia. So post-transaction, it will be, empirically at least, impossible for an independent channel to succeed without Comcast and Time Warner.

Senator KOHL. Well, before I turn it back to the Chairman, is the man right, Mr. Britt?

Mr. BRITT. I think I am familiar with the study that Mr. Gorshein talked about earlier. He uses the word "affiliated" in a very interesting way. The proper concern and the concern of the existing rules is vertically integrated companies, so there is a set of regulations that requires Time Warner as a vertically integrated

company to make its programming available to other people. And those rules apply to News Corp. also and any other cable operator that owns programming.

Programming owned by other big media companies in my case is not affiliated with me. So the Disney Corporation as a third party is just as independent as Mr. Gorshein's company when I deal with them and our negotiations are very fierce.

The only thing I would add to that is that it is true that there is a whole set of rules and regulations and laws around the broadcast industry that are called "must carry" and "retransmission consent." And it is true that the big broadcasters have used retransmission consent to foster carriage of their networks. And they do own a large number of cable networks, so that is a true thing and it does affect independence. And I would say—and Mr. McSlarrow referred to it—elsewhere there is discussion of the digital TV transition and multi-cast. If the Congress decides to go along with multi-cast, that will further hurt the ability of independent programmers, that is, people not attached to a broadcast company, to get carriage.

Senator KOHL. Last comment, Mr. Gorshein?

Mr. GORSHEIN. Yes, I agree with everything Mr. Britt just said, but I will say that in addition to the extra leverage that the broadcasters have, what we define as "independent," not affiliated with a top cable operator or a broadcaster, there is a significant competitive threat brought by newer and cheaper mousetraps to vertically integrated companies that have channels, compete for eyeballs, for capacity, for ad dollars, and there is foregone value.

Senator KOHL. Absolute last comment, Dr. Cooper.

Mr. COOPER. Senator, yes, it is very important and, again, it gets back to my central theme. This Congress creates rights of carriage, the "must carry" rights, and that determines success or failure. If you have got guaranteed rights through ownership or "must carry," you will succeed. And if you don't, you will almost certainly fail. Make no mistake about it. And that is why I suggested the notion of unlicensed spectrum where no one has those rights, where we all find ways to use spectrum without declaring "I am the only one who has a right to transmit in this space," whether it is inside a wire or through the air.

You determine success and failure in this business by allocating those transmission rights.

Senator KOHL. Thank you, Mr. Chairman.

Chairman DEWINE. Mr. McSlarrow, let me ask you a question. How will the digital TV transition impact television viewers? For example, will cable subscribers in Ohio need to do anything specific to make sure that their TVs keep working the same way after the transition?

Mr. MCSLARROW. It depends on what Congress decides to do. If nothing is done, potentially cable subscribers would be affected in the same way that over-the-air customers would be affected—that is, out of 66 million cable customers, 40 million of them have analog-only TV service. So unless they get a set top box or some other converter, their screens would go dark on some channels.

Now, there are two ways to solve that. You can either add all the cable customers into the big subsidy program that Congress is con-

sidering for over-the-air customers and buy them digital-to-analog converters. Or you can do what we have proposed to help the transition along, which is: we will spend our own money, we will re-engineer the cable plant, we will send a digital stream from the broadcaster down to the consumer, and we will send an analog signal down and make sure that everybody, no matter what kind of service they have, is taken care of.

For some odd reason, the current law actually makes it a big question whether or not we could do that. So we have asked the Commerce Committees in both the House and the Senate for that clarification.

Chairman DEWINE. Mr. Aquino, you have told us that vertically integrated cable companies like Comcast and Time Warner are giving each other discounts and charging smaller cable companies more for the same programming. But you also claim that these discounts are not really based on volume or some other legitimate basis. You acknowledge you don't really have evidence of this because programmers' contracts are confidential. But you call for an FTC investigation, which obviously is a very serious thing.

Is there anything specific you can point to that indicates they are doing anything to improperly discriminate?

Mr. AQUINO. Mr. Chairman, I don't know that it is improper or not. From a marketplace perspective—

Chairman DEWINE. You say you don't?

Mr. AQUINO. I do not.

Chairman DEWINE. OK.

Mr. AQUINO. I am not alleging that there is anything improper. I think the market forces basically state that if they can charge small entrepreneurs more money and they pay for it, they will continue to do so. But if you look at the chart that we presented today, if the MSOs are paying about 30 percent, what we call expense-to-revenue relationship, expense of programming to video revenues, and the DBS providers pay about 40 percent of their expenses for that same service, the over-builders and the rural companies and the new entrants in broadband are paying close to 50 percent.

Now, I would suggest that a premium of that nature is just out of bounds, and we provide fiber, you know, to 150 home nodes. We bring broadband at 10 megabits to the home. So we are part of the broadband movement in the country, but that price difference, that premium, I think is just unacceptable. So we are looking for some help—because I don't see the rates of the other players and we are only looking at public filings, there is no way to really know what kind of premiums we are paying as competitors and whether that kind of premium is justified.

Chairman DEWINE. Mr. Britt, do you have any response to the concerns Mr. Aquino is raising? And, you know, generally speaking, how should we evaluate if a deal with discriminatory or the differences in treatment are based on justifiable business or efficiency reasons?

Mr. BRITT. I guess my only response, I am on the purchasing side of this, too. I buy programming. I don't sell it. And when we negotiate with people, most of whom are not associated with our company, we negotiate the very best deal we can get.

I believe, as with most things in the American economy, when you buy more, you get a cheaper price. If you buy a big box of Corn Flakes, you get a cheaper price per Corn Flake than if you buy a little box.

So I suspect that that happens. Obviously, I am not privy to the details of what other people pay for programming, but I think all of us try to get as good a deal as we can.

Chairman DEWINE. Mr. Gorshein, Dr. Cooper, let me ask you this: You both raise the point that a large percentage of the channels carried by the cable companies are affiliated with either a large cable company or a network that has retransmission rights. It does seem that most of the channels that are carried are affiliated with other organizations, but with regard to a specific cable company like Time Warner, many of the channels they carry are not affiliated with Time Warner specifically.

Is there really any reason for Time Warner to favor content that is affiliated with some other distributor, for example, Comcast? And let me just ask all of you—let me go to Mr. McSlarrow and Mr. Britt. Is there any significance to this fact? I understand that many channels are affiliated with large networks because often those networks can utilize the retransmission consent provision to obtain carriage for them, but really, why are so many of the other channels affiliated with other cable systems?

Mr. Cooper, we will start with you.

Mr. COOPER. Well, from our point of view, this is the dance of the elephants in which the mice in the grass get trampled. Essentially you have entities that have a lot of bargaining power—the networks and the cable operators who have programming—and essentially they have assembled suites of programs in which they have an offering in each of the major categories. We present that evidence in our testimony. And they fill the basic and expanded basic tiers up with that stuff. And if you are not one of those entities who has the leverage to get into that tier, you have almost no chance of succeeding. That is the stunning evidence before this Committee and the Commission.

If you don't get carriage on those networks, past those—in the current model. Now, I would—if we were to have a la carte choice, then individual programs would have to stand on their own and consumers would get a chance to choose—not all or nothing or almost all or nothing, but individual programs—that would change the landscape because that would break the bundles. But as it stands now, you have six entities who simply match each other's suites, get into the basic and expanded basic tiers, and that is it.

Chairman DEWINE. Mr. Gorshein?

Mr. GORSHEIN. Yes, sir. We certainly have no issue with some companies owning lots of channels, and there are six of them that own lots. Comcast in recent years has launched 20 of them, with more in planning and development.

The issue for us is free and fair competition on a level playing field. The antitrust laws are supposed to prohibit discrimination on the basis of affiliation. The program carriage rules at the FCC are supposed to prohibit specifically discrimination on the basis of affiliation by cable operators. Those laws, to our knowledge, have never been enforced. The end result is that of the top 92 channels,

there are only 9 that have no affiliation with a broadcaster or a cable operator. We did a study in the last 2½ years where less than 1 percent of independent channels secured broad-based, nationwide carriage, and most if not all affiliated channels get carriage. Some of those are watched and some of those are less successful.

So what we are looking for is an enforcement, a greater scrutiny and an enforcement of the existing laws that will allow us to compete. Why is it important for us to compete? Competition is good. It is good for consumer pricing. Independent channels, according to Kagan, 130 of the top channels surveyed, independent channels are—sorry, affiliated channels are 300 percent the cost of unaffiliated channels. It is good for consumer pricing. It is good for consumer choices. It is good for diversity.

Chairman DEWINE. Mr. McSlarrow?

Mr. MCSLARROW. It is hard to unpack all of this because it is an odd thing. Here is the cable industry, at a time when most Americans just assumed it was a law of nature that we would get TV with only three stations, that invented diversity of programming. Without cable, there would be no opportunity for the hundreds of networks that are out there. Niche networks, big networks, sports networks, you name it. They are out there for every group in America with their individual tastes and interests. We have almost 390 networks that are getting carriage someplace—that are thriving better in other places than others, I suppose—but are a successful business model. And it is a business model that is working precisely because independents are actually getting carriage.

Now, over the years—and I know this Subcommittee has delved into this—there have been studies about how many and what percentage of cable networks are actually vertically integrated with an operator. That number has dramatically declined. It was only a few years ago that it was above 50 percent; 2 years ago it was 33 percent; and last year it was down to 23 percent. We don't know this year's numbers, but the fact is the trend is actually down.

Now, I think Mr. Britt and others have made the point about retransmission consent, so I don't need to duplicate what they have said. But the point is people do get carriage. They get carriage on the basis of their content and whether or not their ideas are compelling enough. Somebody has to make a call on that. I vote for somebody who actually is worrying about whether or not their consumers like what they are offered and not what the Government or the FCC decide.

A final point: it is an odd thing to hear somebody make the argument that it requires a certain base threshold of subscribers—call it 20 million, which is the number that has been thrown out—in order to survive and then turn around and argue that an a la carte model—which almost by definition guarantees that you will have some smaller universe of viewers—is going to allow you to solve this problem, because we know what happens in an a la carte world. What happens in an a la carte world is that the niche, perhaps marginal, networks—even if they have great ideas—are going to fall off the pipe because they won't have the viewership to sustain them.

Chairman DEWINE. Anything, Mr. Britt?

Mr. BRITT. I don't really have much to add to that except to say that our job is to put together the most attractive package of programming we can find that we think will appeal to the consumers. And there are literally hundreds of ideas for new channels that float around, and we try to do as good a job as we can of deciding what we should buy that will maximize consumer purchase of our product. And that is the role we play.

Obviously, entrepreneurs may have what they think is a great idea and we might disagree, in which case they are disappointed. But I am not sure that the Government should be getting involved in that. I think it is the marketplace at work.

Chairman DEWINE. Senator Kohl?

Senator KOHL. Mr. Britt, when News Corp. acquired DirecTV a couple years ago, the FCC imposed a merger condition forbidding DirecTV from getting exclusive rights to carry News Corp. programming. Would it be appropriate to impose a similar requirement on Time Warner Cable and Comcast with respect to this deal?

Mr. BRITT. That is actually an excellent question. The existing law actually has those same provisions for vertically integrated cable companies, so we live under those provisions today at Time Warner, because when that law was written, satellite was just starting. It didn't apply to satellite.

So what happened in the case of News Corp. and DirecTV was a new vertically integrated entity was being formed of a very powerful programmer, News Corp., and a powerful distributor, DirecTV. So all that happened there was the existing rules that applied to cable were applied to News Corp. They weren't a new set of rules.

There was the added twist that, unlike any cable operator I am familiar with, News Corp. also has a considerable number of broadcast stations, and there was the risk of them using retransmission consent in an adverse way. So there were some additional constraints put on that transaction, that are not really relevant to us. We don't own broadcast stations.

Senator KOHL. Mr. Cleland, do you want to make a comment?

Mr. CLELAND. Yes, if I can make a comment just on program access. I think, you know, all these discussions, back in 1992 program access was essential to launch a competitive video programming market. In 2002, I believe it was, when the FCC decided should they extend program access, I think at that time it was still necessary. But I think it will be 2007, maybe, when it is up again. That is the time when we may have reached a market threshold where program access may no longer be necessary to be mandated by the Government. It is going to be a close call because, you know, Rupert Murdoch doesn't need any protection from anybody and Comcast doesn't. I mean, these are large players. There are many people fighting. They have power on each side. It is not really—I do sympathize. This is not a land—this is the land of the giants. The smaller players, you know, may get trampled. But it is big business, and I think, you know, generally going forward the program access regulatory approach is going to be less and less justifiable based on market forces and the level of competition in the marketplace.

Senator KOHL. Mr. Cooper, how do you feel about that?

Mr. COOPER. Well, the interesting thing to me is that we have got all these good ideas floating around, and it is just dumb luck that the good ideas happen to stick, are 62 percent more likely to be found in the affiliates of the cable operators because they get on the air 62 percent more of the time. And they are 46 percent more likely to be found in the affiliates of the networks because they get carriage 46 percent more than the other people with good ideas.

There is no doubt that there is a structural bias in favor of affiliated programming. There is a quid pro quo with the rights of carriage. And so rather than being—and maybe Scott, who is a straight talker, has put it exactly as it needs to be put to this Congress. All the little guys will disappear. That was not the purpose of the 1992 Act. That was not the purpose of the 1996 Act.

We do not want a world in which the big dozen, half-dozen—this is a fairly small number—decide what succeeds. And if you look at the numbers—look at the Government Accountability Office study. They found a bias in favor of affiliated programming. That creates a hurdle that you ought to care about. If you only care about the market, then we know what will happen. The big guys will succeed and, frankly, rather than have the executives of the cable companies decide what they think the American people want to see, I would like to have the American people decide directly what they want to see by having the opportunity to exercise choice. It will change the business model because there will not be blank TV screens for almost all of the channels. The people who pay for those channels will watch them, and those eyeballs will be valuable to the advertisers who want to reach that demographic.

It is absolutely the case, as suggested, that is a different model, but it is a model that really can work because people will have said, "I want to watch this show, I will watch this show," and the advertisers who want to reach those individuals will be able to find them. It is a different model, but it is one that gives consumers the real choice, and we think that is important. And it keeps a lot more little guys in the business than the current system in which only the big players will survive.

Senator KOHL. Mr. Aquino, when our Committee looked at cable competition, we found that the presence of competitive cable companies like RCN helped keep cable rates down. Last year, Senator DeWine and I commissioned a GAO study on the issue, and the study found that in five of six markets it studied, the consumers' cable bills were lowered by between 15 and 41 percent when an independent competitor was present. An earlier study found markets with wire-based cable competitors benefited by prices that were about 15 to 20 percent below average. But relatively few markets across the country have the benefits of an independent cable competitor.

In your judgment, why is this? And what are the biggest obstacles to the entry of independent companies to challenge the cable incumbents?

Mr. AQUINO. Senator, it comes down to financing from Wall Street and the confidence that they have that entrepreneurs like RCN can succeed. And they evaluate our cost structure, and they look at things that they think are fair and unfair.

I get the question all the time about my programming rates relative to the other players, and I compete ferociously in these markets, and competition is good. Competition will keep both of us honest, will get to innovation. I have fiber almost to the curb in my markets. We have metropolitan fiber rings in major cities. We are offering services to commercial customers as well as residential customers. So competition is good. It really raises the level all around, and ultimately prices will be better for consumers.

But it comes down to investment. If there is a sense that the small guys will disappear by the big guys taking over, that is a problem.

So, you know, I plead before the Committee today to just basically hear some of the comments today. Consumers need to have a choice. We think we can compete. We have been very successful in our marketplace, and many franchises where we compete head to head, we actually win in some cases. So we would like the opportunity to continue to do so.

Senator KOHL. Yes, Mr. McCormick?

Mr. MCCORMICK. Senator, I might add that the franchising process is a significant barrier to entry. We are an industry that began in the voice business. Once we began offering high-speed Internet access, the technology makes it possible for us to provide video. The cable industry is an industry that began in the video business. Once it added high-speed Internet access, the technology made it simple for the cable industry to offer voice. But the franchising process is a significant barrier to entry.

I had mentioned the situation in Otswego, Minnesota, where we have a small telephone company with 13,000 subscribers that goes out and invests to deploy a network capable of offering voice and Internet access and video to a set of customers. Those customers today are getting voice and Internet access, but they are not getting video, despite the fact that the facilities are capable of offering it, because the local franchising authority has said you must build beyond your telephone service area into a different service area to match the cable service area. It is wholly arbitrary. It is economically impractical. And all it results in is consumers being denied that choice.

So we think it is important that Congress undertake an examination of how the franchising process is imposing a barrier to entry.

Senator KOHL. Mr. McSlarrow?

Mr. MCSLARROW. If I could actually respond to the last two comments.

First on the GAO report, let me just say very quickly for the record: That was, as you said, a study of a paired set of 12 communities nationwide, half with overbuilds, half without. There are a total of 433 communities nationwide with overbuilders, and if you go and look at all the competition we have from two satellite providers, there is actually a total of 10,000–30,000 communities, excuse me—that have competition in them. And in each case, if an overbuilder comes in, either because they bought the system for pennies on the dollar and got a cost break; or because they didn't actually have build-out requirements, as we have been talking about, so they had a cost advantage over the incumbent; or because they just didn't get the market right and decided they will dive

down on price and force competition with the cable guys; it turns out in most cases they just got it wrong. This was not actually a sustainable, competitive price model.

If you look at the ins and outs, RCN has done a great job in the last couple of years, and I applaud that. But the history of this business has been one of financial instability because it is very hard. The assumption that there is not effective competition taking place today is belied by the fact that it is very hard—with cable and the two satellite providers—to get into the video market and dive down below on price. But we are going to see it again now with the Bells. This is their tried and true model on price. They have already done it on DSL. They are going to try to do it with video, and that is fine. We will see how this shakes out.

But I would say that in terms of franchising—and Walter and I are friends outside this room—this is a complete fantasy. The only thing holding back the Bells from getting franchises has been the Bells themselves. The rules that are on the books today are the rules the Bells asked Congress for in 1996. They actually acquired over 100, I think, franchises along the way and decided they did not want to pursue that business until recently. Now they have decided to get into video again. That is fine. We are going to have that kind of competition. But they want to change the rules and get a subsidy, in essence, by saying we should play by a different set of rules.

When we were talking about phones before, everything that we have done, when we have rolled out our services, complied with the rules on the books. We have never come to Congress and said, "Change the rules for us." And all we are asking is that the Bells be treated the same way.

If you want to change the rules going forward, that is fine. Let's have that conversation. But do it for all of us.

Senator KOHL. All right. Mr. Cleland, do you believe that the challenges that cable companies face, such as difficulties in gaining access to programming, and for the phone companies, gaining franchises, seriously harms the ability of these competitors to compete in the marketplace? And if you do, what legislative or regulatory changes do you believe will help solve some of these difficulties?

Mr. CLELAND. I think that you are going to see increasing competition and innovation. I actually am very much an optimist in this market, I think what is happening in this expanding pie. Essentially what you have is technology is enabling new services, and new services are being piled upon the basic ones. And so I look ahead and I think, especially in the video programming space, it is going to be a very rich competitive market. And I look at it and I kind of say, why are we so focused on prices? People are getting so much more value for their dollar out of entertainment than they did in the past. That is why it goes up. And, you know, value is going up, so price is going up. And when you compare entertainment pricing over TV relative to what you get when you go to a ball game or when you go out to eat, it is just, you know, still an incredible bargain. People will spend a lot more going forward on entertainment.

The questions on legislation, I think that the laws on the books, whether they are telecom, they are cable, they are broadcast, they

are ancient and they are an impediment to innovation, productivity, and economic growth. And Congress—and in my testimony I lay out an approach which says we really should think about going back and doing a clean slate because the problem is all these rules and regulations and laws were based on technologies where we assumed there was market power and we assumed that people needed to be protected from technology. And now we are in a situation where technology can actually help people, and we have all sorts of impediments of essentially silo regulation.

So I guess I am one of the view where I think Congress should take a really deep, hard look and say going forward in the 21st century, why do we have some of these 1930's laws. I am not saying have no law, but I think you can get rid of 90 percent of it and protect 10 percent. And one of the things I think is mandated—you know, BIT cooperation so that people don't go dark, so you can make sure that the network stays to be powerful. That is the minimal level of regulation, and it can be outsourced to be arbitrated by private entities. But the law—telecom, broadcast, and cable, and all of these laws need to be completely pulled out at the roots and start over for the 21st century.

Thank you for asking.

Senator KOHL. Thank you very much, gentlemen.

Senator DeWine?

Chairman DEWINE. Well, we appreciate everyone's testimony very much.

Mr. Britt, just one last question. I don't know if I asked you this before or whether you covered it. In regard to Adelphia, what would people expect in regard to their price per month? Are they going to expect a change? I mean, is that something that people can look for or—

Mr. BRITT. Mr. Chairman, I think that will vary by location. We price locally according to market conditions. We don't have a national price, so there really isn't a blanket answer.

I would not anticipate major changes in price, though. They have been competing with some success, although, as we point out, they are bankrupt. We will be adding many new services that will have the prices they have, but I don't expect big, giant changes.

Chairman DEWINE. Well, we appreciate everyone's testimony. As we have heard today from, really, I think all of our witnesses, the video marketplace is in flux. We have seen major changes in the last few years in terms of new products, new services. Increasingly now we are seeing different players become involved in telephone service, video service, data service, all to the benefit of consumers as well as business customers. As we move forward, it will be increasingly important that the laws and regulations that guide these markets are clear, are consistent, and are drafted to promote the maximum amount of competition. The more competition we have, the more innovation and better products and prices we will all see.

Accordingly, that will be the goal of our Antitrust Subcommittee as we look forward to rewriting the Telecom Act and reworking the various laws that impact on the telecommunications and video industries more broadly.

Our witnesses today have provided us with valuable insights as we consider how to increase competition in these various industries, and this hearing has, I think, been an excellent first step in that direction. So we thank all of you very much. Senator Kohl and I thank you for being with us today. We look forward to talking with you in the future.

Thank you very much.

Senator KOHL. Mr. Chairman, I just need to make another comment. I had been inclined to be much more difficult with Mr. McSlarrow than I have been, and it is because, as you know, your wife, who is a good friend of mine, you brought along to stand in the back of the room to probably modify my approach. And it has had its effect.

[Laughter.]

Chairman DEWINE. We thank you all.

[Whereupon, at 3:42 p.m., the Subcommittee was adjourned.]

[Submissions for the record follow.]

[Additional material is being retained in the Committee files.]

SUBMISSIONS FOR THE RECORD

RCN Connect to something more.

RCN Corporation

Testimony of Peter D. Aquino, President & CEO

October 19, 2005

Hearing on

"Video Competition in 2005 –

More Consolidation, or New Choices for Consumers?"

before the

United Sates Senate
Committee on the Judiciary
Antitrust, Competition Policy and Consumer Rights Subcommittee

Testimony of Peter D. Aquino, President & CEO
RCN Corporation
October 19, 2005

Introduction

Good afternoon Mr. Chairman, distinguished members of the Subcommittee. My name is Pete Aquino, and I am the President and Chief Executive Officer of RCN Corporation. We appreciate the opportunity to appear before you today to present our view, as the nation's first and largest wireline cable competitor, on the state of video competition in 2005.

More consolidation in our industry appears to be a given. However, whether that trend results in more choice for consumers, or results in a competition-crushing duopoly, is very much in the hands of Congress and the regulators. The competition policy that Congress sets in the next 18 months will, I strongly believe, determine who gets to dictate the kind of video programming that is available, and at what cost: Will it be consumers that get to choose? Or the biggest cable companies and the former Bells?

To enable the broad-based competition that gives cable consumers real choice, ensuring competitive access to programming and regulatory fairness is key. To that end, I'll be asking you today to consider taking these steps:

- Communicate to the Federal Communications Commission and the Federal Trade Commission the importance of conditioning the Adelphia merger and similar future transactions in ways that mitigate the ability of huge, vertically integrated cable companies to choke off competitors' access to the programming they control;

- Introduce and promote an amendment to the existing program access law to close the so-called "terrestrial loophole" that allows vertically integrated cable companies to circumvent the existing program access rules;
- Request the FTC to open an investigation into the massive, secretive rate discrimination that results in competitors paying vastly more for video programming than do the large incumbents; and
- Reject the former Bells' demand for franchise relief and other special concessions, and require them to enter them market on the same footing as RCN and other competitors.

We believe that cable choice should rest with our subscribers, as expressed in a fair, open, and competitive marketplace. I hope you agree.

Personal Background

I started in this industry in 1983 at New Jersey Bell in Newark, New Jersey, right out of college, and a few months before the AT&T Bell system breakup. I've now lived through 22 years of competition advancements in the U.S. What I've observed is that we've come nearly full circle, to a point where Verizon and SBC are close to becoming the new "Ma Bell."

I left Bell Atlantic in 1995. Even 10 years ago it was clear that broadband, with its capacity to deliver multiple services through a single, highspeed, high capacity pipe, was the future. I believed in the company's mission to promote broadband, and dedicated my last several years at Bell Atlantic to working on the vision of broadband convergence.

From 1995 to 2000, I was part of the team building one of the first "triple play" voice, video, and Internet networks in Latin America, in 9 cities in Venezuela. We had built broadband in Caracas before many cities in our own country had broadband. Accordingly, I can offer a perspective on competition – and the impediments to competition – that comes from a wide ranging exposure to the conditions that foster innovation in the communications marketplace.

About RCN

I took the helm at RCN at the end of 2004 when the reorganized company emerged from Chapter 11 proceedings with a new management team, a new Board of Directors, and a much improved balance sheet. In 2005, RCN is the nation's premier "triple play" wireline broadband provider, offering voice, video, and Internet access services to primarily residential customers, in competition with Comcast, Time Warner, and other incumbent, former monopoly cable companies. RCN currently has more than 850,000 customer connections in major markets on the East Coast, including Boston, New York, the Philadelphia area, Pennsylvania's Lehigh Valley, and DC, and in Chicago, San Francisco, and Los Angeles. Our current network passes approximately 1.4 million homes, and we have approximately 6 million households under franchise. I am very proud to report that RCN achieved revenues of $141.4 million in the second quarter of this year, and $19.8 million in EBITDA.

Competition Benefits Consumers

I also am proud of the fact the RCN's presence in the marketplace has produced documented benefits for consumers, including more choice, network upgrades, better

customer service, and a check on ever-rising cable rates. It is well established that competition from both direct broadcast satellite providers, such as the Dish Network and DirecTV, and wireline video providers, such as RCN, pushes down cable rates and improves service for consumers. The FCC has said: "In communities where head-to-head competition is present, the incumbent cable operator has generally responded . . . by lowering prices, providing additional channels at the same monthly rate, improving customer service, [or] adding new services. . .."[1] Indeed, as the U.S. Government Accountability Office has reported to this Committee, competition from wireline cable competitors like RCN has been shown to be the single most effective constraint on cable prices, resulting in rates that are as much as 15-41% less than consumers pay in non-competitive markets.[2] It is not surprising, therefore, that the cable incumbents often respond to competition aggressively by withholding or threatening to withhold essential programming and by offering our customers predatory discounts that are not made available to the general public.

New Investment Requires a Fair Opportunity to Compete

Cable competition's success in delivering results for consumers could be dramatically expanded, if Wall Street had confidence that the regulatory environment will foster continued competition. As it stands, however, investors remain extremely

1 *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, Eighth Annual Report, 17 FCC Rcd 1244 at ¶197 (2002).

2 A GAO report on wireline broadband service providers ("BSPs") completed in 2004 said: "The rates for telecommunications services were generally lower in the 6 markets with BSPs than in the 6 markets without a BSP. For example, expanded basic cable television rates were 15 to 41 percent lower in 5 of the 6 markets with a BSP when compared to their matched [demographically comparable] market [without a BSP]." U.S. Government Accountability Office, Report to the Subcommittee on Antitrust, Competition Policy and Consumer Rights, U.S. Senate, *Wire-Based Competition Benefited Consumers in Selected Markets*, February 2004, Highlights, at 1.

reluctant to invest in competitive broadband networks, since many analysts believe that the current regulatory structure – and the changes for which the Bells and cable giants are lobbying – are designed to entrench a duopoly comprised exclusively of the existing mega-cable conglomerates and the new "Ma Bell." Consequently, RCN is constrained from reaching many households that it would otherwise build to if capital were more available, and consumers are deprived of competitive choice.

Congress now has a window of opportunity to change the perception that the cable market is destined for duopoly. To enable continued diverse competition and encourage additional broadband investment, the investment community must be convinced that new entrants and developing competitors like RCN have a fair shot at delivering their products to consumers. This requires two things: First, as RCN, the direct broadcast satellite (DBS) providers, Verizon, and others have recently argued to the FCC, fair access to programming, which is the lifeblood of competition, must be assured. Second – and here we are at odds with Verizon and the other former Bells – the phone giants must not receive franchising and other concessions that allow them to enter the market with an advantage over existing competitors.

<u>Cable Consolidation Threatens Competition</u>

One of the greatest threats to competition is the continued consolidation of the largest incumbent cable companies. Comcast's and Time Warner's proposal to acquire the <u>Adelphia</u> cable systems and to swap systems among themselves highlights the trend toward ever greater consolidation in the cable market, and the threat to programming access that such consolidation poses. In these transactions, the 5th largest cable operator will cease to exist, and Comcast and Time Warner will emerge as

the 1st and 2nd largest video programming providers in the country, with combined subscribership of 43.4 million customers, and 46.8% of the market. The Consumer Federation of America and Consumers Union have reported that approximately 1.8 million of the 6.9 million cable subscribers destined to change hands in the Adelphia transactions are "pure transfers between Comcast and Time Warner designed to allow these two firms to consolidate their control over key markets." Comcast and Time Warner tout the fact that Comcast will become more integrated in Pennsylvania, Minnesota, southern Florida, the Washington, D.C. metro area, and New England, while Time Warner will consolidate its hold on markets in western New York, Ohio, Texas, Maine, southern California, and the Carolinas. By increasing each company's regional "clusters" of cable systems, these proposed transactions will significantly increase Comcast's and Time Warner's ability to use their regional dominance to impair competition from developing in their respective markets. As the only wireline competitor to Comcast and Time Warner in many of their markets, we have seen firsthand the enormous potential for these large cable operators to use their vast market power for anti-competitive ends. The comments RCN has filed with the FCC in the Adelphia proceeding highlight our concerns, especially regarding <u>program access</u>. The FCC has recognized this problem:

> [W]e believe that <u>clustering</u>, accompanied by an increase in vertically integrated regional networks affiliated with cable MSOs that control system clusters, <u>will increase the incentive of cable operators to practice anti-competitive foreclosure of access to vertically integrated programming</u>.[3]

[3] *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, Report and Order, CS Docket No. 01-290, 17 FCC Rcd 12124 (2002), at ¶ 47 (emphasis added).

The consumer groups and other competitors to cable have raised similar concerns.

DirecTV, in particular, has presented a compelling argument that the proposed Adelphia transactions threaten access to "must have" regional sports programming for competitors and their customers. In its comments to the FCC, DirecTV reported that its analysis showed a merger-induced increase in the Herfindahl-Hirschman Index ("HHI") for at least 10 of the regional sports markets in which Comcast and Time Warner operate, in amounts well above the threshold for an adverse presumption, ranging from a low of 325 to a high of 837, in markets whose HHIs already indicate a high degree of market concentration.[4] DirecTV correctly points out that RCN cannot be denied fair access to News Corporation-owned regional sports programming, as a result of the conditions imposed on News Corp's acquisition of DirecTV. Fairness dictates that the same conditions be applied to Comcast and Time Warner in connection with their acquisition of the Adelphia systems given the dramatically increased concentration in regional sports markets that will occur as a result of the proposed acquisitions and system swaps.

Comcast and Time Warner control "must have" regional sports programming in many of our markets. Comcast already has secured a huge competitive advantage in major urban markets like Philadelphia by migrating regional programming to terrestrial delivery, and then denying access to its DBS competitors. RCN's contracts for Comcast SportsNet (Philadelphia), Comcast Sports Mid-Atlantic, and Comcast SportsNet

4 *In re the Applications of Adelphia Communications Corporation, Comcast Corporation, and Time Warner Cable, Inc.*, Comments of DirecTV, Inc., dated July 21, 2005, in MB Docket No. 05-192, at iii and 8-10.

Chicago all expire within the next two years, at which time we also will be at risk to losing this essential, non-substitutable programming.

Congress clearly intended to ensure access for competitors to programming controlled by the largest cable operators. But the existing statute covers only satellite delivered programming, and it has become increasingly easy for regionally clustered cable systems to migrate regional programming to terrestrial delivery. By use of this so called "terrestrial loophole," the largest cable operators are able to circumvent the FCC's program access rules and defeat Congress' intent to make programming accessible for competition. This loophole must be closed.

Even where regional sports programming is being made accessible to competitors, the cost of such programming is prohibitive and increasing. Through a joint venture, Comcast and Time Warner will launch in the spring of 2006 a new channel to carry the New York Mets. With this new channel, the number of channels RCN now must carry in order to provide its New York subscribers with local sports has grown to 4. This will result in an increase of approximately 26% in the rates RCN pays for carriage of New York's sports teams, since RCN will have to pay Comcast-Time Warner for the new Mets channel and RCN must continue to carry the Madison Square Garden channel to provide its subscribers with Knicks and other local games, and yet the Madison Square Garden channel, which currently carries the Mets, is only decreasing its rate by 7%. This 26% figure takes into consideration only the increase in costs for the expansion from 3 regional sports networks to 4. RCN also must continue to carry YES (the Yankees channel) and Fox Sports New York in order to provide its subscribers with full local sports coverage, making regional sports carriage in the New York market

the most expensive in the country. Other local markets, however, seem poised to follow suit.

In addition to regional sports, both Comcast and Time Warner control a large slate of national programming, and have signaled their intention to acquire control over even more. For instance, Comcast has announced deals for the movie libraries of Sony and MGM. Comcast also recently acquired PBS Kids programming. RCN's experience with PBS Kids this past summer provides a perfect example of the problems that occur when "must have" programming is in the hands of a large incumbent cable company.

When Comcast entered into a joint venture that gave it control over popular the PBS Kids video-on-demand programming library, it promptly terminated RCN's ability to provide this programming. Regaining access to the programming was made contingent on RCN's negotiating an expensive technical agreement with Comcast, as well as an affiliation agreement for a new Comcast-affiliated children's programming channel called "Sprout." Comcast significantly delayed these negotiations, so that RCN's customers were denied access to the programming for several months. The result was that RCN's video-on-demand usage of the package that had formerly included the PBS Kids content dropped by 75%. Although RCN was able to eliminate the expensive technical agreement with Comcast, RCN was forced to accept new, more costly terms in order to be able to continue providing this vital children's TV to its subscribers.

In another recent example, Comcast has acquired exclusive control over the National Hockey League's Monday and Tuesday games, which it is airing on its OLN channel. In a play to force competing cable operators that carry OLN to pay increased fees for the channel, Comcast moved the NHL games to a different satellite feed.

According to articles in the trade press, Comcast intended to impose a requirement that only providers with a 40% or greater market penetration rate would be allowed to carry the games – a standard not contained in the OLN contract – which would result in only the largest cable operators' customers having access to the games. Although NCTC, the buying cooperative through which RCN and other smaller cable operators purchase OLN, was able to stand up to Comcast this time, and RCN has now obtained access to the NHL games, the problem was not resolved until shortly before game time on October 10th. As a consequence, RCN was unable to complete the necessary transponder switch before the game (a process that ordinarily requires 30-days lead time), and RCN's customers and customers of similarly situated small cable operators across the country were unable to view the first NHL game of the season.

These kinds of problems with access to programming owned by the large cable companies occur regularly, and are continuing to grow. In view of reports that Comcast actively is negotiating for carriage of National Football League and Major League Baseball games, this recent experience with the NHL games is especially disturbing.

The Adelphia Merger Highlights Competitive Issues in the Cable Market Generally

Even where the cable giants are granting competitors access to the programming they control, smaller companies like RCN are being placed at a significant price disadvantage. Artificial "volume discounts," unrelated to actual costs, favor the largest cable companies, none of which compete against each other. Even the buying consortiums, such as NCTC, lack the necessary scale to stand up to behemoths like Comcast and Time Warner, who will control access to nearly half of all pay-TV viewers in the country if the Adelphia transactions are approved. Despite RCN's membership in

NCTC, we believe our programming costs, due to discriminatory pricing, are nearly double those of the large cable companies. This is difficult to establish, because programmers impose draconian confidentiality requirements on their rates, and we do not have access to the secret rate cards that set programming prices for the largest operators. What we do know is that roughly 32% of our programming dollars currently go to programmers affiliated with Comcast and Time Warner. As their control over "must have" sports and other programming grows, so too does their ability to raise rates to the point that competitors are simply driven out of the market.

Furthermore, the largest of the cable companies exercise their market power to dictate not only rates, but also how programming will be bundled and promoted. Consumers end up paying for programming they don't want, because it is "tied" with the programming they desire. (The retransmission consent rules result in similar tying arrangements imposed by broadcasters, who now own a substantial number of cable networks.) Programmers dictate that their channels must be included in a particular tier, increasing the overall price of that tier for consumers. Programming is promoted based not on market forces, but on non-negotiable terms dictated by huge companies with monopsony market power. RCN has indicated its willingness to participate in a market trial of themed or mini-tier "a la carte" programming offerings, but currently is precluded from doing so by contractual terms imposed by programmers. Intervention by Congress or the FCC is required if consumers, rather than programmers, are to be given the opportunity to dictate what cable customers get to see.

Finally, the sheer size of the largest cable companies allows them to influence the rates of unaffiliated programming providers. The big cable operators get huge

volume discounts, which then pressures the programmers to make up the financial impact by charging small competitors much higher rates. Because there is no rate transparency currently, we believe an investigation by the FTC is imperative, to fully illuminate the extent of the discrimination and its anti-competitive effects.

The Bells Shouldn't Get Special Concessions

I know that the former Bells entering the video programming market will face similar problems with program access, and I look forward to working with Verizon and others as we work toward solutions.

On the other hand, RCN is strongly opposed to the special concessions the Bells are attempting extract as a condition of their entry into the broadband video market. We welcome this additional competition from the former Bell telephone companies, which could help to balance the market power of the large cable companies and bring additional choice and benefits to consumers. A big cable MSO / Bell duopoly, however, is not in consumers' best interest. So, it is essential that Congress not succumb to the Bells' siren song and grant unnecessary concessions that will benefit the incumbent phone companies to the detriment of competitive pioneers like RCN.

RCN came into the broadband market in response to Congress' invitation in the 1996 Telecommunications Act, and in reliance on the pro-competitive intent of that Act. RCN negotiated some 130 local cable franchise and open video system agreements when it entered the market, and is operating successfully under more than 100 active agreements today. For this reason, the Bells' position that they need relief from local franchising is, in our view, simply not credible. If RCN could do it, so can the Bells. Although, in the majority of instances, RCN negotiated cable franchise agreements, we

also invoked the open video system regime created by Congress in the 1996 Act, where appropriate. Although this regime was specifically conceived by Congress to enable phone companies' entry into the video programming business, there is no evidence that Verizon or others have made any effort to utilize OVS as a mechanism for market entry. Rather, instead of working with the tools Congress provided in the 1996 Act, and after negotiating only a small handful of cable franchises with local jurisdictions, the former Bells immediately began demanding sweeping, nationwide regulatory relief. This demand for special treatment should not be countenanced.

Local franchising ensures that companies using the public rights-of-way provide a quality service to consumers and cooperate with other competitors to safeguard consumer choice. We believe that working with municipalities and with the companies that already occupy local rights-of-way is beneficial to the community.

Which brings me to a second concern with the way in which the Bells are entering our market. More and more frequently, RCN is being asked to move or rearrange its existing network – at RCN's expense – in order to make room for the Bells on utility poles and in conduits. This simply isn't fair. While we understand the need to cooperate to make optimal use of shared facilities, we believe the Bells should bear the cost of their network deployment – not RCN.

RCN is not asking for special consideration – only a level playing field. Certainly the Bells, with their vast resources, shouldn't get concessions either. If the Bells are granted any of the regulatory relief they are seeking, it will become even more imperative that the problems with access to programming be remedied, if competition is to survive.

Where Competition Exists, Consumers Are Winning

There is one market currently in which RCN competes with a smaller cable company that does not wield the excessive market power of Comcast, Time Warner, or the former Bells, and that is Lehigh Valley, Pennsylvania. The Lehigh Valley, where RCN competes head-to-head with cable operator Service Electric, is unique in the country in that cable competition has existed there for some 40 years. Service Electric does not control "must have" programming, nor has it received preferences in franchising or rights-of-way access, making the Lehigh Valley market a model of what can occur when the cable marketplace is truly fair, open, and competitive. The data bear out the benefits. RCN and Service Electric share the total number of cable subscribers in the market roughly equally (RCN has about 45% of the market, Service Electric has about 42%), and DBS serves the remaining 12-13% of the market. And, I am pleased to report that customer satisfaction in Lehigh Valley is very high. RCN recently was recognized by the local newspaper as the "Readers' Choice" for best provider of cable TV, telephone, and Internet services in the Lehigh Valley, Pennsylvania, area.[5] Service Electric was chosen the number one cable operator in the state by the local trade association, the Broadband Cable Association of Pennsylvania.

[5] The Readers' Choice Awards are part of an annual poll taken by *The Morning Call* newspaper, with readership of more than 477,000 people during the week in Lehigh, Northampton and Carbon counties, and the surrounding Pennsylvania counties of Berks, Bucks, Montgomery, Schuylkill and Monroe, plus Warren County, New Jersey.

Conclusion

RCN is asking Congress to help us replicate the Lehigh Valley success story by taking several straightforward steps to keep the marketplace competitive and to ensure consumer choice. We ask that you consider:

- Communicating clearly to the FCC and FTC that the proposed Adelphia transactions must be conditioned so as to require that Comcast and Time Warner give competitors access to programming they control, at rates and on terms equivalent to what they give themselves;
- Imposing similar conditions on any future mergers in the cable industry;
- Enacting legislation to close the "terrestrial loophole," so that programmers affiliated with the largest cable companies no longer can circumvent the program access rules;
- Requesting that the FTC immediately open an investigation into the rates and terms for video programming to illuminate the current discriminatory pricing structure that favors the largest cable operators and to debunk the myth that these discriminatory rates are justified, and report its findings to Congress prior to the next legislative session; and
- Rejecting the former Bell companies' request for relief from franchising, and requiring the Bells – not their competitors – to bear the full costs associated with their network deployment.

* * *

On behalf of RCN, I want to thank you Mr. Chairman and members of the Subcommittee for this opportunity to present our views. I will be happy to provide

additional background materials in support of the points I've raised today, and to answer any questions you may have.

TESTIMONY OF GLENN A. BRITT
CHAIRMAN AND CEO
TIME WARNER CABLE

VIDEO COMPETITION IN 2005:
MORE CHOICES FOR CONSUMERS

before the

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY, AND CONSUMER RIGHTS

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
WASHINGTON, DC

SEPTEMBER 28, 2005

Introduction

Good morning Mr. Chairman, Senator Kohl, and members of the Subcommittee. My name is Glenn Britt, and I am Chairman and CEO of Time Warner Cable. I want to thank you for inviting me to appear here today to discuss with you the remarkable and pro-consumer transformation that has occurred, and is occurring, in the cable industry. Driven by technological advancements and fueled by years of steady investment, networks designed for the delivery of one-way video service have evolved into digital thoroughfares capable of bringing consumers a "triple-play" of advanced video, high-speed data, and now voice service. This dramatic shift is part of a larger transformation within the communications marketplace that is bringing consumers new products and more choices as cable operators and our rivals fiercely compete for each and every customer.

The Transformation of the Competitive Landscape.

Time Warner Cable is the nation's fourth largest multichannel video programming distributor, with nearly 11 million basic video subscribers in thousands of communities across 27 states. It is a clear indication of the transformation that has occurred in the competitive landscape that the two companies immediately ahead of Time Warner Cable in the list of top multichannel providers are not cable television companies. They are direct broadcast satellite companies – DirecTV and EchoStar. In little more than a decade's time, these two companies have attracted over 25 million subscribers – by comparison, it took the entire cable industry more than 30 years to reach the 25 million subscriber threshold. DirecTV and EchoStar have achieved this remarkable result through a combination of innovative service and aggressive marketing. They have

benefited in particular from the ubiquitous national reach of DBS technology, which has allowed them to mount cost-effective national advertising campaigns, often with tie-ins to national retail chains.

At Time Warner Cable, we have long recognized and responded to the competitive challenges posed by DBS operators and others. Almost 30 years ago – a lifetime in the fast-paced world of communications – we launched the first attempt at an interactive television service – the QUBE system in Columbus, Ohio. During the late 1980s, Time Warner Cable developed hybrid fiber coax architecture, which paved the way for the suite of advanced services that we and others have subsequently rolled out, and for which we were awarded an Emmy. In 1994, Time Warner Cable introduced an even more advanced interactive, digital network in Orlando Florida.

In 1996, we began a $5 billion upgrade of all our systems. Our video customers saw immediate benefits from these upgrades in the form of improved picture quality and increased service reliability. And with the introduction of digital television service, we were able to offer subscribers an unprecedented array of diverse programming choices – literally hundreds of channels – as well as a veritable alphabet soup of new video services: HDTV ("High Definition Television"), DVR ("Digital Video Recorder"), HD-DVR ("High Definition Digital Video Recorder"), VOD ("Video On Demand") and SVOD ("Subscription Video On Demand"). Also in 1996, we launched our Road Runner high speed data ("HSD" or "cable modem") service. High speed data service has transformed the Internet, encouraging the development of a seemingly endless stream of new tools for communications, education, business, and entertainment.

When we launched high speed data service, we not only were setting ourselves apart from our DBS competition, we were taking on the incumbent telephone companies and their dominant role as providers of dial-up Internet access. And our success in competing with the phone companies in the Internet arena set the stage for our next step – entry into the delivery of residential and business telephone service through the introduction of Voice over Internet Protocol ("VoIP") service, which we call "Digital Phone."

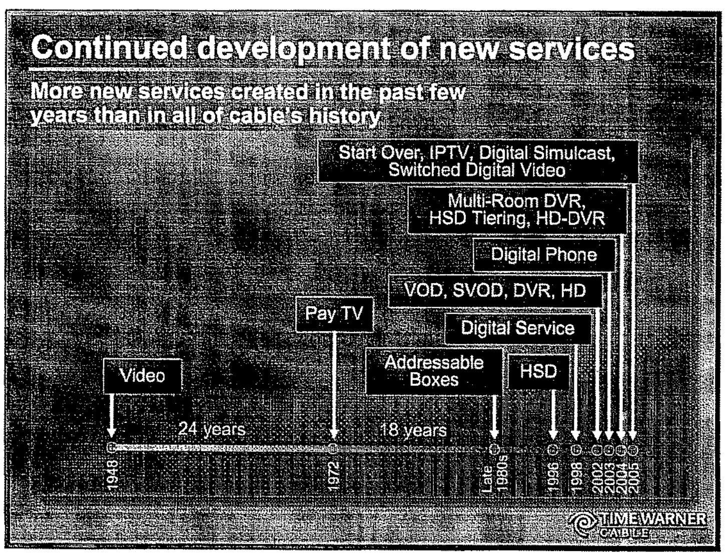
It is fair to say that having been spurred into action by competition, Time Warner Cable's response – and the response of other cable operators that followed our lead – is triggering a further, and even more profound, transformation of the competitive landscape. The incumbent phone companies are fighting back, and fighting back hard, now investing billions in upgrading their facilities in order to provide video and other new services. And in today's super-competitive environment, the battle is no longer about video customers, and high speed customers, and voice customers. Today, the competition is about bundles of service – the so-called "triple play" of video, voice, and data. And it is not just a clash between cable companies and phone companies. Wireline overbuilders, wireless service providers, power companies, and, of course, DBS, are all part of an extraordinarily dynamic marketplace that will provide consumers with more choices and better choices than ever before.

Time Warner Cable's Response to Ever-Increasing Competition.

I have already described how Time Warner Cable responded to the increased competition created by DBS and how our response has served as the catalyst for the current transformation of the competitive landscape into a battle between providers of

multiple services. I want to give you some additional detail regarding the types of advanced services Time Warner Cable has been introducing and how consumers are responding.

We see innovation as having two interrelated facets: consumer driven innovation and technical innovation. As I mentioned, since the mid-1990s, Time Warner Cable has invested over $5 billion in infrastructure upgrades; as a result, over ninety-nine percent of our subscribers are currently served by cable systems with at least 750 MHz capacity, all capable of carrying two-way broadband communications. This technical innovation has made it possible for us to innovate on the consumer front – to satisfy our customers' demands for new and better products and services. Indeed, as illustrated by Figure 1, Time Warner Cable has introduced more new services in the past few years than were created during all of cable's history reaching back to the 1940's.



Some highlights that amply illustrate our success in utilizing our technically innovative platform to deploy innovative consumer-oriented services include:

Digital Cable:

> Our introduction of digital video service has allowed us to offer consumers an unparalleled diversity of programming choices, opening the door for the creators of innovative content. Time Warner Cable currently has affiliation agreements with over 100 independent program networks.
>
> Subscribers to Time Warner Cable's digital video service receive all the channels included in the basic and standard tiers plus dozens of additional digital cable networks and up to 45 CD-quality audio music services.
>
> Over the past year, Time Warner Cable added over 1 million digital video subscribers, giving us more than 5 million subscribers as of June 30, 2005. Our basic service to digital service penetration stands at more than 46 percent.

HDTV Programming:

> Time Warner Cable's systems currently offer an average of 15 HD channels, including HBO, Showtime, ESPN, Discovery, HDNet and iN DEMAND, HD sports programming from Fox's regional sports networks and NBA-TV, HD and other digital signals broadcast by numerous local television stations, including all such stations owned and operated by ABC, CBS, NBC and Fox. There is no extra charge (apart from the necessary equipment) to receive the broadcast HDTV signals.
>
> Almost five years ago, in November 2000, Time Warner Cable entered into a groundbreaking agreement to carry the digital signals of local PBS stations, presaging the industry-wide NCTA/PBS carriage agreement reached earlier this year.
>
> Time Warner Cable's rapidly growing HD subscribership was nearly 654,000 as of June 30, 2005.

Video On Demand (VOD):

> Time Warner Cable was the first company in the industry to fully deploy VOD. As of January 2003, all of Time Warner Cable's divisions have been offering VOD content to all their customers with advanced digital set-top boxes. These digital set-top boxes provide subscribers with interactive program guides and access to other on demand offerings.

Time Warner Cable's VOD services enable subscribers to instantaneously view programming stored on servers at the system's headend, and to utilize functions such as pause, rewind, and fast forward.

VOD is being used by Time Warner Cable to provide a wide range of content, including local content. Both in Milwaukee and in our Ohio divisions, we have launched local VOD channels that present, among other things, free on-demand replays of evening newscasts; travel information for local residents and tourists; local restaurant reviews; school plays and concerts and a variety of unique community arts programs and events. This local VOD content has proven to be extraordinarily successful:

- In Ohio, children's reading programs produced in association with a local literacy group have been some of our most popular VOD content and the local library has indicated that there has been an increase in the take-out rate of books we have featured.
- Our Wisconsin On Demand service has become the Milwaukee division's second most popular free VOD content (ahead of such services as the Cartoon Network, Comedy Central, and PBS Kidschannel).

Subscription Video On Demand (SVOD):

Time Warner Cable's SVOD offerings provide digital customers with the ability to view an array of programming associated with a particular content provider for a separate monthly fee or as part of their monthly fee for the relevant service.

SVOD is currently offered in connection with premium channels such as HBO, and it is expected that SVOD programming offerings will continue to expand.

As of June 30, 2005, Time Warner Cable had 1.7 million SVOD subscribers.

Digital Video Recorders (DVR/HDTV-DVR):

DVR functionality enables subscribers to record programming on a hard drive built into the set-top box through the interactive program guide, and to view the recorded programming using functions such as pause, rewind and fast-forward.

DVR users can also record one show while watching another, record two shows simultaneously, or even pause "live" television.

Time Warner Cable offers DVR functionality in its digital set-top boxes in all of its divisions, and as of June 30, 2005 had 1.1 million DVR subscribers. In addition, in 2004, Time Warner Cable introduced HD-capable DVRs.

High Speed Data/Home Networking:

Time Warner Cable currently has over 4.5 million HSD subscribers, consisting of over 4.3 million residential subscribers and approximately 193,000 commercial accounts.

Each Time Warner Cable division typically offers multiple levels of service, each with different maximum upstream and downstream data transfer rates.

We recently launched faster download speeds (up to 8 Mbps) in all our divisions; unveiled an all-new, redesigned version of our Road Runner High Speed Data service; and are devoting increased resources to customer service.

Time Warner Cable also offers home networking options that allow customers to connect multiple PCs to a single cable modem.

Earlier this year, J.D. Power and Associates ranked Road Runner Business Class, Time Warner Cable's commercial broadband service, "Highest in Customer Satisfaction" among broadband data business customers.

Voice Communications:

Time Warner Cable leads the industry in rolling out Voice over Internet Protocol ("VoIP") services over managed broadband networks.

Time Warner Cable began technical trials in Portland, Maine and Rochester, New York as early as 2000 – years ahead of most other MSOs; in 2003, we rolled out our residential voice service, Digital Phone, first in Portland and then in North Carolina and Kansas City. Digital Phone has now been launched in all Time Warner Cable divisions and is currently available to over two-thirds of Time Warner Cable's homes.

Digital Phone provides unlimited local, in-state, and long distance calling to the U.S. and Canada, as well as call waiting, caller ID, and "Enhanced 911" ("E911") services for a flat-rate, all-distance monthly fee. Digital Phone subscribers can make and receive calls using virtually any commercially available telephone handset. Subscribers switching to Digital Phone can keep their existing landline phone numbers, retain their directory listings, and have access to toll-free 800 calling, Telecommunications Relay Services for the disabled, directory assistance, and operator services.

Digital Phone is also CALEA-compliant, permitting the interception, when necessary, of both call identifying information and call content in response to lawful requests. Time Warner Cable views this as a critical aspect of its service in this time of heightened national security and law enforcement concerns.

Our Digital Phone package has been an enormous hit with consumers. Time Warner Cable now has more than 614,000 customers and, in the second quarter of 2005, we averaged more than 15,000 new customers per week. In less than two years time, we have reached penetration of up to 12 percent in the areas where the service was first rolled out.

The Future of the Competitive Landscape

One thing that has become clear is that a company cannot stand still in today's super-competitive environment for the provision of communications services. And Time Warner Cable has no intention of standing still. Our twin goals are to bring more new services to our customers and to bring more new customers to our services.

An example of one of the new services that we are planning to introduce is an innovative VOD offering that we will begin testing in Columbia, South Carolina. Tentatively called "Startover," this service is a cross between a DVR and VOD that stores every show airing over a licensed network at the system headend and allows viewers to begin watching a program in full from the beginning at any time during its airing. We also are currently conducting a test in San Diego of an IP video service called "Broadband TV," which allows Road Runner customers to watch cable television programming over their home computers.

To further our goal of bringing our services to new customers, Time Warner Cable and Comcast, as you know, have entered into a series of agreements whereby the two companies would separately acquire various cable systems currently operated by the bankrupt Adelphia Communications Corporation. The Adelphia systems currently lag behind both Time Warner Cable and Comcast in the deployment and marketing of advanced services, including HD and cable modem service. Most notably, Adelphia has not yet offered a facilities-based, voice communications service to any of its customers.

In acquiring the Adelphia systems, we will accelerate the pro-competitive roll-out of these advanced services to consumers. For example, in the state of Ohio, approximately 800,000 Adelphia customers (more than 500,000 in the Cleveland-Akron (Canton) DMA) will become Time Warner Cable subscribers, giving them the benefit of Time Warner Cable's proven technological leadership, stable management, and high quality service.

In addition to purchasing the Adelphia systems, Time Warner Cable and Comcast will exchange certain systems as part of the companies' ongoing efforts to rationalize their geographic service areas. Even after the Adelphia acquisition and the system swaps with Comcast, however, our regional footprints will be dwarfed by the national reach of DBS and the contiguous multi-state territories of the incumbent phone companies.

Time Warner Cable has pursued a policy of sensible clustering for a number of years and 75 percent of our current customers are located in clusters of more the 300,000 subscribers. The FCC has recognized on several occasions that the efficiencies inherent in regional clustering makes cable operators more effective competitors and facilitates the launch of new services, such as voice and data. Among the benefits accruing from Time Warner Cable's clustering strategy have been the enhanced ability to launch news and information channels targeted to specific geographic areas: Albany, NY ("Capital News 9"); Austin, TX ("News 8 Austin"); Charlotte ("News 14 Carolina – Charlotte"); New York City ("NY1 News" and "NY1 Noticias"); Raleigh ("News 14 Carolina – Raleigh"); Rochester, NY ("R News"); and Syracuse ("News 10 Now").

The Adelphia/Comcast transactions will further enhance our existing clusters without posing any threat to competition. Indeed, both our current customers and the customers of our newly acquired systems will benefit from a variety of such efficiencies

and economies of scale, including shared equipment and management costs, elimination of system redundancies, more cost-effective promotion and marketing (especially in connection with the introduction of new services), and more responsive customer service. The result will be more opportunities for the development and deployment of innovative new service offerings in competition with the regional phone companies and national satellite services.

Conclusion: The Consumer Wins

As I sit here today, I cannot help but think of those who have come before Congress over the years predicting that a telecommunications revolution is just around the corner. Well, as I look around at this room and note the flat screen televisions, the cell phones and blackberries, the laptops connected through wireless routers – it is pretty clear that the future is now. But Time Warner Cable has no plans to stop innovating and we don't expect our competitors to stop either. It will be, as I described it earlier, a "battle" in the marketplace just as Congress envisioned.

The changed competitive landscape puts pressure on all providers. It also puts pressure on government to reassess its regulatory policies. We support such efforts because as competition increases, old regulatory models may no longer be necessary or appropriate. In conducting this review, an important guiding principle should be to treat like services alike. And at the end off the day, as long as the government does not step in to play favorites, I am confident – and you can be confident – that competition will produce a clear winner: the American public.

"Video and Telecom Competition is Increasingly Vibrant and Here to Stay & Recommendations on Telecom Reform Legislation"

Testimony of Scott Cleland
Founder & CEO of Precursor

Before the
Senate Subcommittee on Antitrust,
Competition Policy and Consumer Rights
Of
The United States Senate Committee on the Judiciary

Hearing on
"Video Competition in 2005
– More Consolidation or New Choices for Consumers?"

September 28, 2005

Thank you for the honor and opportunity to discuss the state of competition in the communications sector and for the request for insights into what this Subcommittee should consider in Congress' potential update of the 1996 Telecom Act.

I am Scott Cleland, Founder and CEO of Precursor, an independent investment research firm specializing in the technology, telecom and media sectors. In December of 2004, Institutional Investor Magazine, in its first national rankings of independent research firms, ranked Precursor #1 in Telecom and #3 in Technology research. Precursor has blazed a trail in the new specialty of Change Research, anticipating investment risk and opportunity from changes in technology, competition, regulation, and other external factors - for institutional investors. The positions presented here are my personal opinions and not those of Precursor or any other entity.

I. Video and Telecom Competition in 2005 is Increasingly Vibrant and Here to Stay:

State of Video and Telecom Competition: As both the video and telecom marketplaces are increasingly converging and inter-related, I am addressing the state of competition in both markets.

- **Video Competition**: This Subcommittee and Congress at large should be pleased with the fantastic success of the anti-monopoly thrust of both the 1992 Cable Act and the 1996 Telecom Act. The facts are overwhelming that neither the cable industry nor the local phone business is a monopoly anymore and that competition in both the video and telecom marketplaces is increasingly vibrant and here to stay. For the vast majority of consumers in the vast majority of markets, consumers have substantial and increasing choice in both the video and telecom markets.

  The success of bringing competition to the video marketplace has been exceptional. After only a decade, over 28 million Americans have exercised the new choice they have in the marketplace of a video provider other than cable, which Congress viewed as a monopoly in 1992. Now roughly 30% of Americans get their video from a non-cable provider. Even better, if any video provider acts in a manner that a consumer dislikes, *virtually all Americans have the freedom and choice* to tell their current video provider to "take a hike" and quite easily sign up with a direct competitor. Despite the large amount of past and pending consolidation, non-cable providers, DirecTV and Echostar are still the #2 and #4 largest video providers in the United States. Cable's competitors now have comparable market clout in programming and equipment

markets that cable providers do. The speed and magnitude of this competitive transformation is remarkable. *The facts scream for everyone to see that cable is not a monopoly.*

Better yet, the real threat of competition cattle-prodded the cable industry to change its ways, to provide better service to its customers and provide customers better technology to get more products and services. The once-monopoly-cable industry has adapted to a competitive environment the old fashioned way, by investing to improve their product and service. Cable has invested about $90 billion in risk capital to build what is currently the best broadband consumer network in the Nation -- allowing cable to become the Nation's leader in providing broadband services to the American consumer. And cable's customer service has improved dramatically. Now a cable company, Cox, is the best telecom company in America according to JD Power. Surprisng? It gets better. After over a decade of promises and false starts it appears that some telcos, like Verizon in particular, are finally getting serious about entering the video business.

- **Telecom Competition**: The same competitive market dynamic is playing out in the telecom space following Congress's 1992 expansion of wireless licenses through PCS spectrum auctions, the decision to have the National Science Foundation unleash and commercialize the Internet, and passage of the 1996 Telecom Act. Over the last decade, most of the large local telcos have lost between 15% – 20% of their phone lines to competitive substitution, plus ~10% to resellers. These companies are losing between 4.5% – 5.5% of lines per year. Americans now have the choice of three to five wireless providers to replace their local phone service and about 7% of Americans have already "cut the cord" and made that choice. Moreover, these providers are adding broadband wireless service in the coming year to further enhance the wireless value proposition relative to landline by enabling VoIP-like and other applications. Furthermore, in about one-third of America, Americans can choose their cable company for phone service and that will likely increase to at least two-thirds by 2006. In addition, VoIP providers are growing very rapidly. Vonage already has a million customers and Skype enjoys over fifty million users worldwide. And while still many dismiss the potential of Broadband over Powerlines (BPL) as a real technological substitute to DSL, cable modems and phone service, they have missed the dramatic technological developments in chips, modulation techniques, wireless, that have completely transformed BPL technology from "wannabe" status to the real thing. <u>Competition in telecom is increasingly vibrant and here to stay</u>.

Important Caveats:

- **Look forward, not backward.** First, this Subcommittee and Congress should look forward, not backward and adapt antitrust vigilance and competition oversight to new and different kinds of potential anti-competitive behavior that remain or could emerge. The technological predicate of competition has changed with the advent of IP packet data, essentially enabling previously distinct technologies and industries to enter each others businesses. While IP packet data enables the potential for tremendous increase in competition, it likewise enables and creates new ways to behave anti-competitively. More competition does not mean there will not be bad actors or bad acts. Enforcement and antitrust will remain as relevant and important in the future, albeit differently and probably less frequently as the marketplace becomes more competitive and naturally self-correcting.

- **Biggest remaining anti-competitive threats**: Second, this Subcommittee and Congress should remain vigilant to predatory practices to deny access to critical facilities (like 911 access points) or some wholesale services *with the intent to damage or harm a competitor's ability to compete*. Predatory denial of access to networks, content, applications or devices *without legitimate business reasons or with the intent to damage or harm a competitor's ability to compete*, could be the biggest remaining threat to competition in the IP packet data era.

- **Another risk to competition – non-disclosure of network use limitations:** Non-disclosure of use limitations by network providers is a big risk to competition because markets assume and need good information so that consumers individually and collectively can exercise their free choice to switch providers based on what that provider will and will not allow a consumer to do. In a competitive and free market:
  - Network providers must have the property right to ultimately control and manage their networks; and
  - Consumers and businesses also have the right to have products and services marketed to them clearly, fairly, and truthfully so that they have the information to make wise and informed buying decisions.

- I believe the best way to ensure that the emerging consensus around "Net Neutrality" is achieved, is to rely on market forces with providers obligated to openly and fairly represent any restrictions their network may impose on users' freedom to access any legal content,

application and device of their choice. If an informed consumer or business chooses to limit their freedom by knowingly buying a product or service that does so, in the presence of competitive choices, that's the essence of a free market. If consumers or business don't like it they can let their provider know individually or collectively and they can always take their business elsewhere. So as the market becomes more competitive in video and telecom, I recommend this subcommittee embrace market forces over regulation, be vigilant in antirust oversight and emphasize more enforcement of network use disclosure, fair representation, and truthful advertising. This is the free market approach that well serves businesses and consumers throughout much of the economy.

- **Don't saddle tech software companies with legacy telecom regulation**: One of the biggest dangers to the emergence of a lasting and vibrant competitive video and telecom marketplace is the FCC potentially burdening tech and software-based communications providers with legacy telecom regulation which applies to common carriers or legacy cable regulation which applies to incumbent cable providers. Regulations from the monopoly physical world have no business being applied to the competitive virtual world of IP. The FCC's well-intentioned effort to ensure that VoIP providers either provide 911 services or make clear to customers that they don't, was also apparently in response to anti-competitive pressure from some telcos who saw a competitive gain to be achieved by making it hard for VoIP providers to access their legacy-monopoly 911 facilities. The FCC needs to be vigilant against the siren song of legacy regulated providers, and not allow competitive unregulated businesses be pulled into the swamp of legacy telecom regulation.

- **Outdated communications law inhibits market forces and consumer choice**. The transition from monopoly to competition is largely but not entirely complete. Unfortunately for our Nation's consumers and businesses, video and telecom law is replete with entrenched and outdated law that is ultimately detrimental to consumers because it inhibits technology and market forces from supplying the consumer and business demands of the video and telecom marketplaces. Per the subcommittee's direction, in the appendix to this testimony, I will provide insights and recommendations on how the Judiciary Committee could look at the opportunity for Congressional reform of U.S. communications laws.

II. Current Issues: Bell Entry into Video; Adelphia Transaction; and Program Access:

Bell entry into video: After over a decade of hype, un-met promises and false starts, I believe the local telcos are finally serious about entering the video market. Much like it took the new DBS entrants for cable to become more competitive and invest in new infrastructure, it is taking the much broader cable offering of cable into telephony for local telcos to begin preparing to offer a competitive voice-data-video bundle of services. It is *only the breadth and seriousness of the cable telephony/VoIP threat* that is moving the telcos, because Cox has been a serious telephony threat for several years. The local telcos are probably five years behind cable in offering a voice-data-video bundle to *as broad a swath of consumers as is cable*. Of the large telcos:

- **Verizon appears most serious about video.** They have thousands of contractors deployed now in several cities laying fiber and they are in franchise negotiations with over 200 localities to offer video. They have a competitive program package to offer in their pilot markets like Keller, Texas. Verizon has chosen the most expensive infrastructure approach, fiber to the premises (FTTP). Costs and return on investment aside, FTTP has many advantages over SBC's Fiber to the Node approach:
    - FTTP is a leap-frog attempt to end up on the other side with the best infrastructure just like cable leap-frogged DBS — on data.
    - FTTP enjoys more complete de-regulation than hybrid fiber-copper infrastructure like SBC.
    - FTTP offers more potential for value-added services and operational savings.

- **SBC appears the least serious about video.** We have been questioning SBC's commitment to video because we have not seen much hard evidence that video is a true competitive priority outside of their press releases. There has been little hard evidence that they are seriously spending or digging to fiber-ize for video a la Project Lightspeed. SBC has ended, slowed or changed its DBS reselling model no less than three times. And finally, SBC still is unique in its official stance that local telcos don't need a local franchise in order to offer video, and hence has not entered into negotiations with a single local franchise. I question SBC's seriousness about entering the video business because there is probably not a single local franchise that does not want to approve SBC's video entry. With effort and admittedly very serious time hassles, SBC like Verizon, could pursue a near certain negotiation outcome with local franchises. Instead, SBC is putting "all its video eggs in one basket", the hope for state or

Federal relief from the local franchise obligation that has been the law of the land for nine years.

- **Bell South is well prepared but under the radar.** Bell South has been the most forward-looking and fiber-prepared of the Bells by far. Bell South already has more fiber closer its customers than SBC will have in a couple of years when it gets around to completing Project Lightspeed. Once again the facts speak loudest. By far the fiber-izing leader of the Bells, Bell South has almost half (46%) of its lines with either fiber to the curb (7%) or fiber deep in the network so the copper loop is short, <5,000 feet, (39%) which enables ADSL IPTV when IPTV software is ready for primetime in the next year or two. In 2004, BellSouth spent about 30% of its capital expenditures on fiber/broadband and plans to spend ~40% in 2005. In its understated but serious way, Bell South is prepared to enter video when it believes its chosen technology is ready. Unlike SBC and Verizon, which were clearly caught by surprise that they needed to get local video franchises, Bell South was well aware of the requirement for quite awhile. Bell South already has 20 local video franchises covering 1.4 million subscribers, which they will leverage first. They currently are not negotiating with any other local franchises.

- **Qwest can only afford DBS resale.** Investing heavily to offer fiber video to its customers just isn't in the cards for Qwest because they simply do not have the free cash flow or profit margin to be able to heavily invest in their infrastructure. Their lasting weak financial condition is a legacy of the bubble problems that left Qwest on the brink of bankruptcy in 2002.

Adephia Transaction: I do not see any anti-competitive concerns with the Adelphia transaction, and believe it actually helps consumers.

- First, this transaction carries out the Department of Justice's mandate in the 2002 AT&T Broadband consent decree to sever the substantial cross-ownership interest between the then #1 and #2 cable providers. While this transaction makes each marginally larger, it accomplishes a de-concentration of the market by ending the substantial multi-billion dollar cross ownership interest between Comcast and Time Warner.
- Second, this transaction will fully rescue the roughly five million U.S. subscribers to Adelphia from the nightmare of being served by a former criminal enterprise that is currently in bankruptcy protection. This transaction will bring these subscribers under reputable and highly-competent management which will be able to greatly increase the value proposition to these customers.

- I do not see how this transaction creates market power; it is a classic geographic extension of the market, not eliminating a competitor. The cable industry's clustering strategy is not anti-competitive, but competitive because it brings efficiencies and enables more effectiveness in infrastructure, overhead, logistics, advertising and customer service.

Program Access: In 1992, the program access law and rules were absolutely necessary and wise to level the playing field and allow new DBS entrants to emerge and challenge the incumbent cable monopoly. And the FCC was wise to extend Program Access rules in 2002. However, I believe the FCC will have a much harder time justifying their extension in 2007, because the factual predicate underlying the purpose of the rules has changed sufficiently to make the rules an un-necessary government intrusion in the marketplace to protect consumers. With #2 video provider DirecTV having nearly 15 million sets of "eyeballs" (subscribers) and owning popular Fox programming, NewsCorp is more than capable to take care of itself in any programming negotiation. Echostar with over 10 million subscribers is a market force as well. I believe in an increasingly competitive marketplace, it will be increasingly difficult to justify increasingly intrusive governmental intervention in the marketplace when the original purpose has been fulfilled.

III. Conclusion:

Thank you again for the opportunity to testify on the state of video competition. Video and telecom competition is increasingly growing, providing more choice for consumers and economic incentive to innovate and improve products and services. The advent of real competition between cable providers and local telcos will add to the competitive dynamic and benefits for consumers and businesses. Congress should look forward and not backward, and seriously consider a "clean slate" overhaul of communications laws in order to better bring the Nation together, and better promote economic growth, job creation, productivity, innovation and international competitiveness. Please see the Appendix for an elaboration of my views on pending telecom reform legislative efforts.

Appendix:

Requested Analysis and Recommendations on What the Senate Judiciary Subcommittee on Antitrust Could Consider when Congress Addresses Telecom Reform Legislation

**"Current Telecom Reform Is Not Ambitious Enough;
Laws Must Adapt to a Competitive Marketplace**

I. The Communications Legislation Problem:

U.S. communications laws are woefully out-of-date — based on mid-20th century technological capabilities and business models, and on the factual predicate of legitimate concern about lack of true competition. Not only are U.S. communications laws based on depression-era technology models but also on a outdated and discredited approach that Government is better than markets in managing technology and economic tradoffs. This Depression-era approach to technology and communications is depressing America's future and stunting America's potential economic growth, productivity and innovation.

The fact that U.S. communications laws have not kept pace with technology advances is creating real national problems:

- Impeding real and potential technology productivity, safety, and lifestyle-improving benefits for consumers;
- Producing counter-productive and inefficient technology and economic decisions by consumers and businesses; and
- Undermining real and potential economic growth, productivity, innovation, and international competitiveness.

Current legislative efforts to reform telecom laws are surprisingly modest in scope. What is going on is a classic "industry fix" legislative dynamic which by definition are mostly "self-preserving" and disjointed; not "nation-serving" and purposeful. Consequently, I believe current "industry-fix" efforts are unlikely to generate consensus or be successful until the true purpose of the overhaul is based genuinely on:

- American consumer betterment: Fostering tech advances that substantially improve the utility and productivity of most Americans; and

- Economic growth, productivity, innovation and international competitiveness: rather than government conferring advantages or disadvantages on different industries.

U.S. Communications Laws are Badly in Need of Repurposing:

- From a market-power assumed, government-managed communications sector — to a competition-assumed, minimally regulated marketplace with enforcement protections when necessary.
- From monopoly/oligopoly era where technologies, wires and spectrum were functionally separate and distinct — to a competitive era where technologies, wires, and spectrum are interoperable and inter-changeable.
- From regulators choosing technologies and market outcomes — to competitive forces, technologies, and consumer demand determining market outcomes.
- From Governmental mandates and management of market outcomes — to a market forces approach emphasizing consumer and business freedoms and choice.
- From protecting consumers by legally and regulatory limiting technology — to benefiting consumers from unfettered technology, competition and innovation.

U.S. Communications laws are limiting Americans' freedoms: U.S. Communications law and regulation is often counter-productive and restrictive - unnecessarily inhibiting Americans' from benefiting from true:

- *Freedom from location:* current geography-based law/regulation is replete with un-productive constraints on geography-independent IP packet-data technologies to specific locations;
- *Freedom from functionality limitations:* Current U.S. communications law and regulation is based on technology silos which un-productively limit technology convergence to single technology functions; and
- *Freedom from technology and network limitations:* Current U.S. communications law and industry-organized legislation unproductively limits efficiencies of I.P. packet data, any-to-any connectivity and personalization, by focusing on interconnection solely on companies rather than also people and devices.

II. A Communications Legislation Solution: New "Clean Slate" Techcom Legislation:

Need new "clean slate" techcom legislation: Congress should consider *completely replacing* legacy, technology-specific regulation of the 1934 Act, as amended, for telecom, broadcast, cable, satellite and

wireless, because the technological and monopoly/oligopoly predicate on which it is based is no longer the case and is woefully out of date and out of balance, favoring regulation over market forces. Congress should consider passage of technology-neutral legislation that:

- Embraces and harnesses technological innovation and market forces to meet consumer needs;
- Removes government from *prospective* market and technology decision making;
- Delegates oversight and enforcement of commercial interconnection negotiations and general industry disputes to a newly-created industry self-regulatory organization like SEC has with NASD;
- Ensures core public interest goals continue to be achieved with the minimum possible regulation: spectrum licensing and interference enforcement; antitrust and competition oversight; intellectual property: patents, copyrights; basic interconnection obligations, disability access, 911 access and law enforcement cooperation.

To succeed, reform legislation needs a powerful and consensus-building rationale: For a "clean slate" overhaul of communications law to ultimately be successful in updating communications laws for the 21st century, there needs to be a coherent and cohesive national policy that integrates:

- Consensus political principles of freedom and national unity;
- Free market economic principles;
- Homeland Security needs; and
- A forward-looking, market-driven technology vision

Proposed Preamble/Purpose for Communications Legislation Overhaul:

- *Foster Americans' free and unfettered communications access to one another as communications technologies evolve in order to protect and enhance the United States':*
    - *Political and social cohesion and unity;*
    - *Homeland and national security; and*
    - *Economic growth, job creation, productivity, innovation and international competitiveness.*

The fundamental rationale behind this legislative purpose:

- Politically, is the constitutional First Amendment Right to Assemble;
- Economically and technologically, is Metcalfe's Law that "the value of a network scales as 2n where "n" is the # of persons connected to the network;" and

- Homeland Security-wise, is people are safer united in communication than isolated; e.g., 911, E-911, Emergency Broadcast System, spectrum for first responders, etc.

Freedom is the best new organizing principle for Communications Legislation overhaul: Promoting not just companies' freedoms, but also all Americans' rights to be interconnected as widely and freely as possible to others, the economy, and the world by ensuring Americans' inalienable Technology "Freedoms":

- Consumer 'Net Freedoms to:
  - Access any legal content of their choice;
  - Access any application of their choice; and
  - Connect any device of their choice.
- Economic 'Net Freedoms of consumers and businesses:
  - Freedom from location;
  - Freedom from functionality limitations; and
  - Freedom from technology and network limitations

Interconnection Solution: The core constant and unshakeable principle embedded in the 1934 and 1996 Act, and also the Internet, is the national value of Americans' free and unfettered access to one another. The 1934 Act mandated interconnection because AT&T successfully used denial of interconnection to monopolize telecom. At its core, Congress got the 1996 Act dead right in that for competition to be possible in communications, there had to be a mandated duty to interconnect and be interoperable. The Internet is the ultimate outgrowth of this principle — facilitating universal interconnection of networks and people.

What's sorely needed is a better/less intrusive mechanism to oversee and enforce mandated interconnection than government setting all terms. Any legislative overhaul of the law should encourage commercial negotiations for interconnection, peering, and transit. An overhaul should also authorize:

- a self-regulatory organization overseen by the FCC (like the SEC relationship with the NASD) to be the arbitrator and enforcement arm for more contemporaneous and efficient resolution of interconnection and other disputes than the FCC or court can possibly achieve; and
- Authorize negotiating parameters that encourage commercial and non governmental action.

Current law forces every dispute into regulation or in court, which is counterproductive, extremely inefficient and destructively slow.

Consumer Federation of America

Consumers Union

STATEMENT OF DR. MARK COOPER

DIRECTOR OF RESEARCH,

CONSUMER FEDERATION OF AMERICA

ON BEHALF OF

THE CONSUMER FEDERATION OF AMERICA

AND CONSUMERS UNION

VIDEO COMPETITION IN 2005 –

MORE CONSOLIDATION, OR NEW CHOICES FOR CONSUMERS

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY, AND CONSUMER RIGHTS

UNITED STATES SENATE

SEPTEMBER 28, 2005

Mr. Chairman and Members of the Committee

My name is Dr. Mark Cooper. I am Director of Research at the Consumer Federation of America. The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, composed of two hundred and eighty state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than fifty million individual members.[1] I am also appearing today on behalf of Consumers Union (CU), publisher of Consumer Reports. CU is an independent, nonprofit testing and information organization serving only consumers.

CFA and CU have been analyzing and commenting on the cable TV industry in the two decades since it was deregulated in numerous hearings before this and other Congressional committees, in proceedings before regulatory and antitrust agencies dealing with the cable industry including merger reviews,[2] the horizontal limits proceeding,[3] and other public policy proceedings.[4]

We appreciate the opportunity to share our views with the Committee, pointing out, yet again, the numerous anticompetitive effects of mergers between large industry players. Consolidation in the industry has perpetuated and compounded the industry structure, conduct and performance that abuses consumers and strangles independent production of video programming.

The acquisition of Adelphia by Time Warner and Comcast should be rejected. It is not only a merger that will increase the concentration of the national market for video programming, but Comcast and Time Warner have set up a complex web of market swaps that allows them to systematically reinforce their control over the nation's largest regional markets. The evidence from the past decade consistently shows that increased concentration and clustering lead to higher prices for consumers, stifle independent programming and undermine the ability of competitors to enter the market.

Though Adelphia is a smaller cable competitor with just 5 percent of the national market, half of its subscribers are in the top 25 markets and more than two-thirds were in the top 50 markets. The acquisition of customers in these critical markets by Time Warner and Comcast and their associated market swaps of existing territories will dramatically concentrate their market power in regions where most Americans live. The merger will increase the market share of both companies in more than half of the top 50 markets nationwide, giving the top two national cable providers more muscle to thwart competition, impose price increases on consumers, exclude carriage of independent programming and extract anticompetitive deals for carriage of regional networks.

At the national level, after taking into account the joint ventures of the two dominant firms, the concentration in the post-merger national market would exceed the threshold for concern about anticompetitive effects by four- to six-fold.

In addition to unacceptably increasing market power on the selling side, the merger gives Time Warner and Comcast make-or-break power over the market for purchasing video

programming at both the national and regional level. The two companies own systems that pass 32 million homes. Together, they function as the market-entry gatekeepers who decide which programs will reach cable customers and which will not. It is a market reality that independent, unaffiliated programmers cannot survive without carriage by both Comcast and Time Warner: it is impossible to reach the 60 million homes that advertisers currently demand without carriage on *both* of these cable systems. As a result, independent networks that are not carried by both Comcast and Time Warner will not be carried by *any* cable systems.

Regional programming is also a distinct market and this merger creates severe problems of concentration in the nation's largest markets. Penetration into the top urban markets is critical for market viability of any programming. By increasing their regional dominance in top markets as well as their national market control, the acquisition and regional market swaps of Time Warner and Comcast will only exacerbate their anticompetitive buying power.

The regional dominance of Time Warner and Comcast solidified by this merger gives the companies greater power to extract exclusive program carriage rights from independent providers of popular regional programming—especially sports networks—precluding cable competitors from carrying "must-have" regional networks and undermining their market viability. It also gives both companies the power to prevent satellite and other competitors from carrying regional programming owned by the two cable giants. That is, the merger gives Time Warner and Comcast control over not just what will be carried, but also who can carry it.

Moreover, as our testimony demonstrates, the presence of satellite video providers fails to discipline the market in terms of prices to consumers and access of independent program providers to the distribution network. The committee should reject any attempts by regulators to rely on the minimal competition from satellite services. Evidence shows that only head-to-head competition results in any meaningful consumer price relief. Other forms of cross technology competition, from the Internet or telephone companies are nascent at best and not likely to provide relief to the vast majority of the consumers affected by this merger any time soon. Nor is these any certainty that relief for the average consumer, will ever arrive. Policymakers have repeatedly heard promises that a new technology was about to break the market power of the cable operators, but the promised competition has failed to materialize, leaving the consumer with rising prices.

This merger should be rejected. If it is not, regulators must impose meaningful, precise and self-enforcing conditions on the companies, backed up by substantial penalties for non-compliance. Key conditions must include

- prohibitions on demands of the cable operators for exclusive carriage rights from unaffiliated programmers;
- prohibitions on denial of carriage of programming offered by independent, unaffiliated programmers;
- prohibitions on denial of carriage by competitors of regional programming owned, or partially owned by Time Warner or Comcast.

- o divestiture of cable properties in a manner that reduces anticompetitive effects; &
- o prohibitions on the predatory practice of mandatory bundling of cable modem service with basic cable service.

Whatever the fate of this particular merger, Congress needs to confront the larger problems in the industry. The anti-consumer, anticompetitive problems existed before this merger and they will be made worse by it.

In 1992, Congress concluded that limiting the number of homes that a single cable provider could pass would help limit that owner's power to unfairly impede the flow of programming to the public and the FCC set the limit at 30 percent of the national total. It is now clear that such a limit, particularly if applied to regional clusters of cable systems in critical markets, could also serve to reduce the harm that consumers suffer at the hands of the cable industry.

Congress has also begun to recognize the anti-consumer, anti-competitive nature of bundling in the industry. This practice forces consumers to buy huge packages of programming that they do not watch in order to obtain the small number of programs that they do. It reinforces the gate keeping power of the cable operators by denying consumers the choice of which programs to pay.

UNITED STATES SENATOR • OHIO

Mike DeWine

FOR IMMEDIATE RELEASE **CONTACT: JEFF SADOSKY**
OCTOBER 19, 2005 **(202) 224-2315**

HEARING STATEMENT
[AS PREPARED]
ANTITRUST SUBCOMMITTEE HEARING

"Video Competition in 2005 – More Consolidation, Or New Choices For Consumers?"

Good afternoon, and welcome to the Antitrust Subcommittee's hearing entitled "Video Competition in 2005 -- More Consolidation or New Choices for Consumers?" Today, we will examine two important current issues: first, the purchase of Adelphia by Comcast and Time Warner Cable, and second, entry into the video marketplace by the Bell companies.

These two events push the industry in different directions. There is a consolidation with the loss of Adelphia, but an increase in choices for consumers as overbuilders, Internet companies, and the telephone companies roll out video services. These differing market dynamics are representative of the tremendous changes occurring more generally in the entire telecommunications and video marketplace, and these changes have broad competitive implications which must be explored.

Individually, each event is worth some attention and accordingly, we will examine them today. To begin, Comcast and Time Warner Cable propose to divide up Adelphia's cable operations in various markets around the country. This will make the two largest cable operators in the United States even larger. Many have concerns about this small, but potentially significant increase in concentration.

For example, what effect, if any, will this change have on the ability of independent programmers to break into the marketplace? Will the deal give Time Warner and Comcast a greater ability to strike exclusive deals with other programmers, or a greater incentive to utilize the so-called "terrestrial exemption" to prevent competitors from gaining access to their programming? These are issues which we will explore.

While the Adelphia deal gives us some cause for inquiry, there is certainly a significant counterbalance to the questions it raises. As part of this deal, Comcast is giving up its 17% stake in Time Warner Cable and its 4% stake in Time Warner Entertainment, which will remove a large financial connection between the two competitors. Additionally, this consolidation also likely will lead to efficiencies and a greater ability for these cable companies to improve and expand their competitive offerings.
We look forward today to hearing about how Time Warner plans to use this deal to enhance the experience of its consumers.

-More-

Unlike the Adelphia deal, which is in its final stages, the entry of the phone companies into the video business is just in its infancy. But, in the long run, this entry likely will foretell a much more significant change in the marketplace. While the phone companies are upgrading their networks and gearing up to enter video, overbuilders like RCN are offering much needed competition in a number of communities, which is bringing prices down and providing valuable new services for consumers. We will hear today from RCN, as well as the U.S. Telecom Association, to examine how they view the marketplace.

More generally, we will discuss with all of our witnesses what steps are needed to ensure a competitive future for the rapidly changing world of video and telephone service. As we all know, this marketplace is evolving at an extraordinary pace -- the phone companies are beginning to offer video, the cable companies are getting into phone service, and the Internet continues to expand as a medium for all sorts of content. In just a few short years, all of these industries may be completely transformed in ways we can only begin to imagine here today.

But, vibrant competition is not a sure thing. We need to take active steps to make sure that these markets welcome competition and innovation and that new entry is encouraged. Franchising regulations, access to content, and regulatory parity are important issues among many that must be addressed. We have to get it right if we want the market to thrive and provide the maximum choice and value for consumers.

For those reasons, as we reconsider the cable and telecommunications laws in the upcoming months, we need to understand whether current regulations are getting in the way of a more competitive market, and if so, then we need to figure out what different rules will help the marketplace create better products for consumers. This is a task that the Antitrust Subcommittee intends to undertake, and our hearing today is a first step toward learning what we need to do that. So, I hope that all of our witnesses can testify not just about the specifics of the Adelphia deal and of new entry, but also more broadly about how we can help promote competition in these markets.

This Subcommittee has an obligation to examine current laws and regulations to make sure that new entrants into video services have a real opportunity to get into these markets and compete. At the same time, of course, we must respect and understand the regulatory burden already placed on incumbent cable providers and take care to ensure that their long-term efforts and network investments are not unfairly diminished by any changes we make in the legal structure. In the last 10 years, the cable operators collectively have spent approximately $100 billion upgrading their systems and improving their offerings to consumers -- all based on the current laws and regulations. We must keep that in mind as we consider modifying the competitive framework that guides the industry.

This is a difficult balance to strike, but we must strike it correctly, because the reward will be a vigorously competitive marketplace that will ensure the economic vitality of this important sector. Most importantly, it will help consumers, and aid in the creation and deployment of new and better products and services for individuals and businesses. Those, of course, are very worthy goals, and merit our strongest efforts.

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Statement of U.S. Senator Russ Feingold
At the Senate Judiciary Committee Hearing On Video Competition

October 19, 2005

First, I want to thank Senators DeWine and Kohl for calling this important hearing on competition in the cable industry. I believe this is a very important consumer issue that is at a critical stage with proposed mergers and evolving technology changing the marketplace in very significant ways. The unanswered question is whether these changes will provide consumers with more choices, a greater diversity of voices, enhanced local content, and better value for their money.

I have long been alarmed by the soaring cable rates that consumers in Wisconsin and across the country have had to endure. For nearly a decade, dating back to the immediate aftermath of 1996 Telecommunications Act which I opposed, I have been hearing from my constituents about the rising costs of cable services and the difficulties posed by the growing number of other services that are bundled with cable, like high-speed Internet connections, wireless phone service and digital television.

For all of the promises of more services for less money, average cable rates increase each year without much obvious improvement for the consumer. In many states like my home state of Wisconsin, the problem is even worse in rural communities where there often is no meaningful competitor to the local cable operator.

It is essential that we in Congress do everything we can to foster true competition in the cable and video programming industry, and I hope today's hearing will help spur us to act. I am concerned, however, that too often when we speak of competition and fairness, we are focused on the companies involved and miss the mark on what is best for the consumer.

It seems that much of the debate recently has been about Congress picking winners and losers, both between companies in the same industry and between industries as the traditional boundaries shift. While these are certainly important considerations, we should always view these issues through the lens of what is best for consumers, not the providers of the services. I think we often lose sight of this.

For example, local franchise requirements have been a topic of considerable debate. But it seems that the focus is often on whether they give an unfair advantage to the traditional cable companies over traditional telephone carriers. In the din, it is hard to hear the consumers and local communities, who want meaningful competition, but also want to protect the local broadcasts and full community coverage provided through franchise agreements. Where the check goes each month matters much less than having choices, a diversity of viewpoints, local content and reasonable cost for family budgets.

Mr. Chairman and Senator Kohl, thank you again for holding this hearing and for bringing attention to these important issues of consolidation and vertical integration.

TESTIMONY OF DORON GORSHEIN
CHIEF EXECUTIVE OFFICER
THE AMERICA CHANNEL, LLC
BEFORE
THE SUBCOMMITTEE ON ANTITRUST
OF THE
UNITED STATES SENATE COMMITTEE ON THE JUDICIARY
CONCERNING
VIDEO COMPETITION

WEDNESDAY, SEPTEMBER 28, 2005
2:00 P.M.

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to testify today on behalf of The America Channel. I'm here to share our perspective on the state of competition in the video space, based on our experiences as an independent channel seeking access to the consumer.

The America Channel is an independent, nonfiction programming network, set to explore and celebrate America – profiling its diverse communities, local heroes, and ordinary people who accomplish the extraordinary. It is not a channel about celebrities or the latest fashion; but about the everyday heroics and stories of real people -- their struggles, aspirations, and achievements.

The America Channel was founded in the months following 9/11, when I realized that television no longer resonated with my sensibilities as an American consumer. Indeed, our stellar market research results confirmed that many Americans share this view. We discovered that Americans want more relevant programming, about what makes America special, more community, more connectivity and more authenticity on television. This is why we believe that The America Channel could be the most powerful, most resonant new product to come along in quite some time.

We then spent 18 months and one million dollars from investors on planning, development and market research before approaching the cable operators.

As part of our efforts, I traveled to dozens of cable systems across America, which are owned by the top cable operators. The reception was overwhelmingly positive. We believe our level of diligence was as strong as any new channel's.

The key to viability is distribution to a sufficient number of households, and access to certain key markets. Because of the market power of the largest cable operators, access through them is absolutely essential. If they say no, the viability of a new channel is in peril.

Today The America Channel has distribution relationships with the majority of what will become the telco video space. But after nearly 2 ½ years, we've had virtually no progress getting carriage from the dominant cable operators.

Why is this? Cable operators are vertically integrated – they own channels. The telcos and EchoStar do not.

This is relevant because an independent channel is a direct competitor to a cable-affiliated channel on several fronts -- For viewers, ad dollars, technical capacity, and the asset value is independently owned.

New independent channels, typically free to the cable operator for several years, also create downward pricing pressure on affiliated channels. A review of Kagan's reports reveals the average fee for cable-affiliated networks is more than three times (x) the fee for the few independents. One major cable operator derives 40% of its operating income from its television networks (and only 28.6% from cable subscriptions). That operator has strong incentive to exclude less expensive and better products, to protect increased rates for its own channels.

A fully distributed channel is typically valued in the billions of dollars, and generates annual revenue in the hundreds of millions. Thus, vertically integrated cable operators must choose between owning 5% of the revenue and asset value when launching an independent network, or

100% when wholly owned. It's an easy decision, and an inherent conflict of interest that prevents the best value products from reaching the market.

The GAO confirmed that cable operators are much more likely to carry affiliated networks over independents. And we found that each of the top two cable operators over a 2 ½ year period, carried on a non-premium, wide basis, only 1 out of 114 channels with no media affiliation. Meanwhile most affiliated channels are carried.

John Malone recently said, that an independent channel has no chance whatsoever if Comcast doesn't carry it. And CableWORLD magazine reported that VC funding of entrepreneurial cable networks has died, because of the gatekeeping power of top cable operators.

Of the 92 channels that have reached the critical viability threshold of 20 million homes, not a single one did so without at least two of Comcast, Time Warner and Adelphia. 90 out of the 92 have both Comcast and Time Warner.

The Adelphia transaction with its geographical rationalization, if consummated without conditions, could mean the end of new independent networks.

Though we believe the public would embrace The America Channel, this hearing is not about any single product. It is about free competition, for content, and for services.

We believe the telcos and EchoStar, in contrast to the largest cable operators, are squarely focused on free market competition – with better channel selection, lower price, and higher quality customer service. Their success is critically important, and they should be helped, to rapidly deploy their services, and have fair access to content.

Foreclosure of opportunities for independent channels has adverse effect on competition, consumer choice, consumer pricing, and the diversity of ideas in the marketplace. We must have an environment which permits free competition on the merits. It is my hope that our experience will help your efforts to address these systemic problems that play out to the detriment of all Americans.

I ask leave to file additional market statistics as a supplement to the record in this hearing in aid of your efforts to address these issues.

Thank you again for the opportunity to testify.

news from

HERB KOHL

United States Senator
Democrat of Wisconsin

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FOR IMMEDIATE RELEASE — OCTOBER 19, 2005
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STATEMENT OF U.S. SENATOR HERB KOHL ON VIDEO COMPETITION

Washington, DC—Today U.S. Senator Herb Kohl, Ranking Member of the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights delivered the following statement at a hearing on "Video Competition in 2005 – More Consolidation, or New Choices for Consumers?"

Mr. Chairman, thank you for holding this hearing today. We are at a pivotal time for competition in the video industry. The decades long control by local cable monopolies is about to be shaken by the promised entry of the giant telephone companies into video, while satellite has begun to attract a critical mass of consumers. But whether we are about to witness the birth of a new world of expanded choices for consumers will depend to a large extent on the policies adopted in the months ahead.

So today's hearing will address several topics crucial to the development of a truly competitive video market. First, what will be the impact for consumers of the acquisition of Adelphia by the nation's two largest cable competitors? Second, what are the policies we can adopt to ensure that important new competitors in the video market such as the phone companies are given a fair shot to compete? And, third, how can we assure that independent voices have room to be heard in today's media world?

We continue to witness increased consolidation in the industry. The latest deal is the purchase of Adelphia by Comcast and Time Warner. Once the acquisition is complete, Comcast

and Time Warner intend to swap local cable systems to significantly expand their regional presence. This clustering will lead to very high market shares in several regions of the nation – as high as 70% -- from the East Coast to California. Such clustering greatly increases the ability of the local cable franchise to gain exclusive rights to must-have programming -- effectively freezing out competitors.

Increasing concentration also makes it much more difficult for independent programmers like our witness from the America's Channel to obtain carriage. Our democracy depends on the ability of independent voices to be heard. We should be deeply concerned when only programmers affiliated with cable companies or the broadcast networks seem to get carried on the cable giants.

But there is one significant piece of good news – the entry by the regional Bell companies into the video market. By challenging the cable monopoly, the efforts by companies like SBC and Verizon creates the exciting prospect of a real new competitive choice for millions of consumers. But we must ensure that undue roadblocks to the entry of the phone companies into video are removed. Therefore, government should consider the following actions –

First, a careful review of the Adelphia deal by the Federal Trade Commission and FCC to ensure that it does not lead to excessive market concentration in local geographic markets. Central to this review should be a serious consideration of conditions to ensure that competitors have access to programming that consumers demand, as was done in NewsCorp/DIRECTV;

Second, closing loopholes in the program access law to ensure that competitors have access to essential programming owned by the cable incumbents; and

Third, revising the existing rules so that independent programmers have a fair shot at getting carried.

These and other similar ideas should be on the agenda as Congress looks to re-write the landmark Telecom Act of 1996. These measures will help assure that consumers see the benefits of increased choice by giving new entrants the breathing room to compete.

Thank you, Mr. Chairman.

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Statement of Senator Patrick Leahy

Hearing Before the Subcommittee on Antitrust, Business Rights, and Competition:

"Video Competition in 2005 – More Consolidation, or New Choices for Consumers?"

October 19, 2005

I want to thank both Senators DeWine and Kohl for holding this hearing today on an issue that is important to the people of Vermont and indeed to consumers across the country. Subscription video services have become a vital component of America's information infrastructure and for that reason it is long been my goal, to create laws that promote genuine competition, real improvements in service, and better consumer choices in video programming services. Creating laws that meet these goals, result in better prices, more options, and improved service for consumers. Living in the Digital Age, today's consumers should have more choices than ever for video programming services. Unfortunately, in most areas of the United States, this is not the case.

Over the last several years we have made some significant progress towards providing better cable and satellite services for consumers. For example, the most recent FCC report on video competition largely credits the "Satellite Home Viewer Improvement Act of 1999," on which Senator Hatch and I worked closely, with the steady increase in the number of markets where local broadcast television stations are distributed by Digital Broadcast Satellite. I mention this because it means that consumers in even in the most rural and remote areas of the country, like Vermont, are being provided with

more options in their video programming services. This is an important step toward real improvement, but, we must not stop there. There is much more to be done.

Two weeks ago, Vermonters held a town meeting with officials from the Comcast Corporation to discuss the Adelphia buyout by Comcast and Time Warner. At that meeting, several people expressed legitimate concerns over the proposed acquisition and the effect it will have on already exceedingly high cable rates. They were also worried about rural access to cable and broadband Internet connections that are needed in much of the state, and the prospects for survival of local cable channel access stations that provide local and regional programs essential to many small Vermont communities. Certainly these concerns are not limited to the small group of people who attended a Vermont town meeting, but rather, reflect the broader concerns of Vermonters and many Americans.

Comcast and Time Warner are the two largest cable companies in the country and currently control almost half the cable market nationwide. I fear that if they are permitted to acquire Adelphia the result will be a major step back from real and meaningful competition in the marketplace. Consumers are right to question to the future of service rates, programming content, and ability to pay for only those services they want. If past experience is a useful predictor of future outcomes we should be weary of heavy consolidation in the cable market.

When Congress passed the Telecommunications Act of 1996, I was one of five Senators to vote against the bill. I expressed reservations at the time that

the competition predicted by many would fail to materialize. I wish my fears had not proved correct, however, since the Act was signed into law the anticipated competition to drive down rates has come to fruition.

As we move forward and begin to discuss the best ways to reform the 1996 Telecommunications Act, it is my hope that we do not forget the painful lessons of the last nine years. Ever-tightening bonds between corporate control of content and of distribution are having an anticompetitive effect on what consumers can see on their screens, and likely on how much they have to pay for it. This has been, and continues to be, an area of great concern to me and one that I hope our witnesses will address.

I am committed to exploring a variety of solutions that would allow Vermonters and all Americans to enjoy the benefits of greater competition in the cable and broadband industries. I know that other members of this Committee also share that commitment. I look forward to working with them in order to sort through these complex issues.

Statement of the Walter B. McCormick, Jr.
President and CEO of the United States Telecom Association

Hearing Before the Senate Judiciary Subcommittee on Antitrust,
Competition Policy and Consumer Rights
October 19, 2005

Mr. Chairman, my name is Walter McCormick and I serve as President and CEO of the United States Telecom Association (USTelecom). On behalf of our more than 1,200 companies, I'd like to thank you for this opportunity to appear before the Subcommittee to discuss the state of video competition. This hearing comes at a critical juncture as we are entering an exciting new era in video competition. With the assistance of Congress, my members will be able to rapidly deliver more video choices to your constituents.

Before we begin, let me take a moment to introduce USTelecom's members to this Subcommittee. Our member companies offer a wide range of services across the communications landscape, including voice, video and data over local exchange, long distance, wireless, Internet and cable networks. USTelcom's membership ranges from the smallest rural telecom companies to some of the largest corporations in America. We are united in our belief that it is time to update the nation's communications laws to reflect the dramatic technological and marketplace changes all consumers have witnessed in recent years.

In November of 2004, USTelecom's diverse membership completed a process of review and debate that resulted in our Board of Directors unanimously adopting twin principles that we believe should serve as the foundation of reform. These principles are:

1. The establishment of consumer-controlled, market-based competition through the elimination of government-managed competition.

2. The reform of Universal Service to ensure affordable, reliable telecommunications for all Americans in the 21st century.

Over the course of the last year, we have seen wide recognition that the world of communications has changed fundamentally, that competition is intensifying across the platforms and that significant investment is needed to advance our economy and America's global competitiveness and to speed innovative choices and services to consumers.

USTelecom is particularly excited by the introduction of S.1504, the Broadband Choice Act by Senator John Ensign. Senator Ensign's bill will establish a consumer controlled marketplace in telecom that will result in a dramatic explosion in video competition through the establishment of national policies freeing our member companies, and other new entrants, from out-dated regulations. I deeply appreciate the support for this measure from Subcommittee members, Senators Graham and Brownback, who are already cosponsors of this important legislation.

As the Subcommittee examines the state of video competition, we believe there are six aspects worthy of examination:

I. Video is a key driver for broadband deployment

President George W. Bush has established a goal of "universal, affordable access for broadband technology by the year 2007." Video will play a significant role in the rapid and widespread deployment of advanced broadband technology. The video services that local telecom companies (LECs) deploy over their new broadband networks will drive subscriber growth and, thus, network deployment because they offer significant new capabilities.

For example, SBC Communications is planning to offer services with interactive features far beyond those provided with video programming today. In fact, unlike today's cable offerings, SBC's planned services are designed to permit all end users to tailor much of the content and viewing experience, as well as engage in transactions. Ultimately, the aim is to allow, for example, customers to connect to the Internet, access stored files such as email at their computer, use voicemail, or directory information and route communications from their phone or computer, and use their television sets to aggregate content in a manner customized to their preferences.

Verizon Communications has also started deploying its next-generation broadband network—fiber optics to the home (FiOS)—with the intent to offer subscribers new and innovative video capabilities that will allow Verizon to more effectively package and add more value to its products and services. Verizon's FiOS high-speed data services are currently available in parts of fifteen states, and Verizon anticipates passing three million homes by the end of the year. Verizon plans to begin offering video on the FiOS network later this year in the locations where it has obtained franchises (after many months and much effort), which will include cable and broadcast channels, hundreds of other digital video channels, high-definition programming, video-on-demand content, music channels and an interactive programming guide.

And across this nation, there are scores of small, independent telecom companies that are investing in new infrastructure to deliver video choice and innovative services.

II. Video competition from local telecom companies will benefit consumers

Broadband video entry will promote faster and further broadband deployment. Wireline video competition will also generate substantial benefits that are not realized with satellite-based competition alone. Incumbent cable system operators control over 70% of the video distribution market on average, with the remainder going largely to the two major direct broadcast satellite providers, even though a variety of competitors has been attempting to win market share for well over a decade. At the same time, prices for video services across the country have been increasing on average at a pace that far surpasses the rate of inflation even though prices for local telephone, long-distance service, wireless and broadband services have plummeted. According to the General Accountability Office, even with the presence of two satellite competitors, cable operators have been steadily increasing their prices more than 300% as fast as the Consumer Price Index. The American Consumer Institute released a paper this week that finds that – "due to their reliance on television services for their information and news, older consumers are most harmed by noncompetitive pricing."

There is one clear exception to this general rule of cable rate increases—where a cable company faces competition from a wire-based video provider (not a satellite service, and not necessarily a competitor also offering broadband), its rates are approximately 15% lower than

the same operator's rates elsewhere. Where the cable incumbent faces competition with a broadband service provider offering video service, it appears that the cable operator goes even further, according to the General Accountability Office, "by providing more and better services and by reducing rates and offering special deals."

This point was best exemplified in a September 21st Wall Street Journal article discussing Verizon's rollout of video service in Keller, Texas. The Journal noted, "The local cable operator, **Charter Communications** Inc., has responded to the upcoming threat by offering attractive premiums. Typically, Charter charges about $100 a month for high-speed Internet service combined with its top TV package of about 240 digital channels. Since Verizon launched Internet service on its fiber-optic network in Keller, Charter has been offering the two services to new customers in that area for $50 a month for as long as 12 months."

Unfortunately, relatively few consumers see the benefits of the direct competition between cable and wireline multichannel video operators outlined by GAO. Fewer than 2% of the nation's households have a choice of wireline video provider. Chief among the reasons for this state of affairs is the bureaucratic local franchising process, which subjects entrants to needless delay and rent-seeking behavior. Additionally, the build-out requirements – logical in a monopoly environment but antiquated for competitive entry -- often make entry prohibitive and inefficient.

III. The franchising process slows entry and deprive consumers of competitive choices

The current franchising process imposes substantial delay and transaction costs; the uncertainty generated by the process raises the cost of capital for prospective entrants. USTelecom members report average negotiation periods of nine months to one year for each franchise area, with some examples taking as long as three years. This is a major obstacle to broadband deployment should cable style franchises be required for broadband video services. In fact, there are more than 30,000 franchise areas in the country, and new entrants obviously cannot collectively negotiate all 30,000 required agreements simultaneously. Moreover, the transaction costs created by franchise negotiations impact entry even in many individual cities because there are often ten or more franchise authorities in a relevant economic area. While some franchise areas can be negotiated with as a group, this generally does not reduce the overall manpower needed to conclude the negotiation.

In addition to build-out requirements, many other franchise obligations, such as requirements to provide studio facilities and public, educational, and governmental programming channels, arose as mechanisms to ameliorate undesirable consequences of monopoly cable franchises. These franchise obligations often result in restricted output and higher prices. Therefore, it is not surprising that franchise obligations make it harder for competitors to succeed in competition with the incumbent cable monopoly. The original cable operator likely was willing to agree to greater franchise obligations than would a competitive firm because it was receiving exclusivity, and the relatively certain high subscribership that goes with it. Competitive entrants do not receive first-mover advantages. Accordingly, extending the same regulatory treatment to competitors as is faced by the incumbent cable operator is far from competitively neutral; to the contrary, the "level playing field" is anything but level.

I must also note Mr. Chairman that when cable companies began providing voice communication to their customers, they appeared before Congress with the impassioned plea that cable voice service should not to be saddled with legacy phone regulations. In fact they

said, "[The FCC] should remove regulatory constraints, not add new ones.... Imposing those legacy regulations [that apply only to phone companies] —and the costs associated with them—on cable for no reason other than to achieve regulatory parity will harm consumers by raising the price or lowering the quality of cable modem service. It would provide a disincentive for new investment.... [The goal should be to] regulate down, not up." This does seem to prove the old adage, "Where you are is where you sit."

IV. Build-out requirements prevent entry

A major obstacle to the promise of broadband video competition is the application of cable franchise build out requirements. Cable system operators argue that it is only fair that competitors should offer service to all of the same areas where the incumbent operates, yet this obscures the basic fact that the very notion of imposing build-out requirements on competitors is virtually unheard of in our economy. In fact, the very idea of applying build-out requirements to competitors is utterly inconsistent with the core principles of market economics.

The experience of USTelecom's current Chairman, Gene South, Sr. in Otsego, Minnesota is a prime example of how build-out requirements hamper entry and deprive consumers of the benefits of competition. Mr. South is CEO and General Manager of Lakedale Communications, a small LEC with 11,000 lines. Seeing an opportunity to enter additional markets and deploy broadband facilities, Lakedale joined with the Wright-Hennepin Cooperative Electric Association in 1999 to form WH LINK LLC, to build a system capable of providing video services as well as broadband Internet and voice services to portions of Otsego.

WH LINK received authorization to provide local exchange and long distance services in areas including the City of Otsego from the Minnesota Public Utilities Commission on June 15, 2000. With that authorization, WH LINK installed copper and fiber optic network facilities capable of carrying broadband Internet, video, and voice services, and began to provide telephone exchange and Internet access services.

The City of Otsego initiated its franchise application process and both WH LINK and the cable incumbent, Charter Communications, which had been operating under an extension permit, applied for franchises. Charter proposed to serve all areas of Otsego with a density of nine homes or more per quarter mile, and WH LINK proposed to serve a smaller area—five residential subdivisions where it was already providing telephone and Internet service—and to expand its network in the future if the system was successful. Otsego approved Charter's franchise with a seven-year build-out requirement for all areas with a density of nine homes or more per quarter mile. The City approved WH LINK's application conditionally, as well, subject to its acceptance of the same build-out requirement, which it stated was required by Minnesota's "level playing field" statute.

WH LINK rejected this requirement as impractical. Consequently, Charter faces no wireline video competition Ostego. Thus, the "level playing field" statute so assiduously defended by the incumbent cable industry has not helped customers but, rather deprived many Otsego citizens of the benefits of video competition.

Lakedale's experience is far from unique. There is very little congruence between LEC

networks and cable networks (defined by their respective franchise areas). Tellingly, incumbent cable operators do not face build-out requirements when they add services to their networks to compete with broadband providers. The FCC has explicitly held that build-out requirements constitute substantial barriers to entry and, pursuant to Section 253 of the Communications Act, preempted state laws seeking to impose build-out requirements on local telecommunications entrants. Similarly, the FCC has determined that cable companies cannot be required to build out their cable modem data services. These decisions were made as part of broader Commission policies to promote investment and the deployment of new services more quickly to all consumers.

Cable system operators are seeking, however, to require video competitors to build-out entire cable franchise areas. Rather than encourage additional broadband deployment, however, this asymmetry prevents all providers other than the incumbent cable operator from achieving the triple play of voice, video and data. In fact, the real unfairness from a uniform build-out requirement would be that all competitors but for the incumbent cable operator would be required to expand their network into new areas just to offer their existing customers "triple play" service packages. Therefore, imposing cable franchise area build-out requirements on competitors seeking to offer broadband video in competition with the incumbent cable operator would create illogical, even perverse market outcomes.

V. The incumbent cable industry is advocating policies that will prevent entry and slow broadband deployment

The Federal Communications Commission has found that the "local franchise process is, perhaps, the most important policy-relevant barrier to competitive entry in local cable markets." Cable system operator behavior is consistent with this finding; cable system operators historically have brought lawsuits challenging the grant of franchises to competitors— cable engages in litigation to prevent entry. Cable resistance to competitive entry is often styled as being in the interest of "fairness"—the incumbent cable operators argue that new entrants should have to overcome and face the same hurdles that the incumbent faced (which runs counter to the application of communications law and policy in most circumstances).

For example, franchising authorities: impose "requirements for facilities and equipment" on incumbent cable companies; require the dedication of capacity on any "institutional network" for the benefit of the municipality; set unspecified "construction- related requirements;" and impose build-out requirements and schedules that may be especially difficult for a new entrant to meet before it has begun to attract consumers and earn revenues. While many of these requirements would be completely redundant for a new entrant—municipalities should not, for example, need capacity on a duplicative institutional network—the cable incumbents have threatened legal action against franchising authorities that seek to ease the way for new franchises for telecommunications carriers by tailoring them to reflect reasonable differences between the entrenched cable incumbent and the new entrant.

Most recently, cable operators in Texas have sought to enjoin the newly enacted state franchise law designed to allow both cable and competitors to compete. They ostensibly took this action because they remain subject to existing franchise agreements until they expire. Both incumbents and competitors can negotiate new, less burdensome agreements on a

forward-looking basis. It appears however that the Texas cable operators value the protective effect of cable franchise obligations, and wish only to slow competitive entry.

An interesting sidebar on the Texas story. The first certificate granted in Texas under that law was not to SBC or Verizon but rather Guadalupe Valley Telecommunications Cooperative. Guadalupe Valley serves 30,000 customers and is located in a fast growing part of Texas, serving an area north and north east of San Antonio. A video provider since 1981, Guadalupe Valley would take advantage of the new Texas state law to offer video competition to Time Warner in new subdivisions.

Cable operators have also used the power of their incumbency to increase entrants' marketing costs by denying them access to lower-cost, and more effective, cable channel advertising spots for the purpose of advertising the entrant's services. For example, one rural LEC sought to purchase advertising on a particular cable channel at the prevailing market rate to target an offer tailored for a customer segment that favored the channel, but was refused the opportunity to purchase the spot. The cable representative stated that the company didn't accept advertising from the LEC's categories of business (voice, broadband, and resale of DIRECTV). This refusal only makes business sense (as the cable operator was declining its stated price) if the cable operator was calculating that it would prevent subscriber losses by denying access to the advertising spot. In sum, whereas cable systems gained free entry into telephony through the 1996 Act, they continue in their attempts to deny comparably free entry into video markets.

VI. Access to vital programming is necessary for new video entrants to be successful;

The program access rules established in the 1992 Cable Act have been successful in that DIRECTV, EchoStar, USTelecom members, and cable overbuilders (such as RCN) generally have been able to access the programming they need to compete. Increasingly, however, the program access rules are likely to be circumvented by technology as terrestrial distribution of video signals is increasingly common. Accordingly, the Commission and Congress may need to take greater steps to deal with and ensure the equal access to programming that is essential for an efficient, competitive market for broadband video services. This is an issue recognized and addressed in Senator Ensign's Broadband Choice Act.

Mr. Chairman, thank you for this opportunity to appear today. This hearing has begun an important process; one that will update our telecom laws to provide greater opportunities for the American people. We appreciate this opportunity to offer our insights into how best to achieve this bold vision. We look forward to working constructively with you, the members of the committee, and the staff to develop sound policies that advance the U.S. information economy and the innovative choices of America's consumers.

NCTA

TESTIMONY OF KYLE McSLARROW
PRESIDENT AND CEO
NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

on

VIDEO COMPETITION IN 2005:
NEW CHOICES FOR CONSUMERS

before the

SUBCOMMITTEE ON ANTITRUST,
COMPETITION POLICY, AND CONSUMER RIGHTS

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
WASHINGTON, D.C.

OCTOBER 19, 2005

I. INTRODUCTION

Mr. Chairman, members of the Subcommittee, my name is Kyle McSlarrow and I am President and CEO of the National Cable & Telecommunications Association. NCTA is the principal trade association for the cable television industry in the United States. It represents cable operators serving more than 90 percent of the nation's 66 million cable television households and more than 200 cable program networks, as well as equipment suppliers and providers of ancillary cable services. NCTA's member companies provide consumers with a wide variety of quality services, including video (digital and analog), High Definition Television (HDTV), high speed access to the Internet (cable modem service), and telephone service (both traditional circuit-switched and Voice over Internet Protocol).

Thank you for inviting me to testify today about the state of competition in the video marketplace. You have asked specifically whether the video marketplace in 2005 offers consumers "more consolidation or new choices." The answer is clearly new choices.

The video marketplace is more competitive than ever before. Just ten years ago, cable was a one-way analog video service which enjoyed 95 percent of the multichannel television market. Today, it is only one of many interactive broadband platforms that provide a variety of voice, video, and data services – many of them digital. Thanks to fierce competition from two Direct Broadcast Satellite (DBS) providers, EchoStar and DirecTV, cable's market share has fallen to 69 percent. And now the Regional Bell Operating Companies (RBOCs) are entering the fray, bringing with them an annual revenue stream of $150 billion – about three times that of the cable industry.

There is a fierce battle going on today between cable, satellite, and telephone companies to provide television households with state-of-the art video services – and new providers are entering the field every day, including Internet-based services, video cell phone providers, wireless computer

manufacturers, and consumer electronics suppliers. Consumers are the beneficiaries of this highly competitive landscape, where they enjoy a wide array of advanced video services, diverse programming, and the ability to choose from among at least three multichannel providers.

Evidence of a highly competitive marketplace can be found not only in the choices available to consumers but also in the conduct of cable operators and their competitors. When DBS began to offer consumers an alternative with more channels, more pay-per-view movies, and digital audio and video, cable operators embarked on a $100 billion, nationwide upgrade of their facilities (see Appendix A). With additional capacity and digital capability, cable operators began to offer new tiers of digital programming, along with video-on-demand and digital video recording capability. Cable expanded its video services to offer high definition television programming. Cable also increased the quality and diversity of its programming and pioneered commercial high-speed Internet service.

The availability of bundled video, data, and voice services and the introduction of interactive broadband services by cable operators prompted a competitive response from other industries. Telephone and DBS companies, for example, joined forces to offer their own packages of video, voice, and data services. Today, Verizon and SBC are investing billions of dollars to enter the video marketplace while cable is seeking to develop Voice over Internet Protocol (VoIP) service to better compete with the incumbent telephone companies.

The bottom line is that these are all signs of a competitive marketplace: several different providers of a wide array of services vie with each other for customers, each trying to differentiate themselves with unique offerings while trying to match those of their competitors.

II. CABLE FACES VIGOROUS COMPETITION IN THE VIDEO MARKET

Today, consumers can choose from a variety of multichannel video providers. The Federal Communications Commission (FCC) reported in January 2005 that "almost all U.S. consumers have the choice between over-the-air broadcast television, a cable service, and at least two direct broadcast satellite (DBS) providers." In some areas, the FCC found, "consumers also can choose to receive service via one or more emerging technologies, including digital broadcast spectrum, fiber, and video over the Internet."[1] The net result is that "consumers today have viable choices in the delivery of video programming, and they are exercising their ability to switch among MVPDs."[2] In addition, "through the use of advanced set-top boxes and digital video recorders, consumers are now able to maintain more control over what, when, and how they receive information."[3]

DBS continues to increase its share of MVPD customers, while cable fights back to maintain and enhance the value and attractiveness of its service. Cable also competes with a host of other video delivery media, including broadband service providers (BSPs), utilities, municipal overbuilders, Internet video providers, broadcasters and home video outlets. **As a result of this competition, 28.3 million consumers (more than one out of four video subscribers) now obtain multichannel video programming from some company other than their local cable operator.**

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[1] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 20 FCC Rcd 2755, 2757 (FCC 05-13; "11th Annual Report").
[2] Ibid: paragraph 6.
[3] Ibid: paragraph 4.

Subscribers to Multichannel Video Program Distributors (MVPDs), March 2005

	Subscribers (in Millions)	Percent of Total MVPD Subscribers
DBS (high power satellite)	25.40	27.43%
C-Band (low power satellite)	0.30	0.32%
MMDS (microwave)	0.10	0.11%
SMATV (private apt/condo)	1.10	1.19%
Broadband Competitors	1.40	1.51%
Non Cable MVPD	28.30	30.56%
Cable	64.30	69.44%
Total MVPD	92.60	100.00%

Sources: NCTA estimates based on data from Kagan Research LLC, *Kagan Media Money*, and Nielsen Media Research.

Direct Broadcast Satellite

DBS and cable presently compete for every customer, old and new. DBS companies currently have more than 26 million customers compared with none 11 years ago. The two nationwide DBS providers now serve more than 27 percent of all multichannel video households and their penetration is 25 percent or greater in at least 25 states. In the second quarter of 2005, surpassing analysts' predictions, DirecTV increased its subscriber base by a record 505,000 net customers, while EchoStar grew by 325,000 customers.[4] DirecTV now has more customers (14.67 million) than all but one cable operator (Comcast). EchoStar, the second largest DBS provider with 11.46 million subscribers, ranks third among all MVPDs. Cable made significant gains in digital cable and high speed Internet customers in 2005, but its share of multichannel video customers has fallen below 70 percent.

DBS operators continue to experience strong subscriber growth in virtually every market where they offer local channel service.[5] Indeed, DirecTV and EchoStar report that their total number of subscribers increased from 23.16 million to 26.13 million between June 2004 and June 2005, an increase of 12.8 percent.[6] According to Strategy Analytics, "DBS has robbed cable of the slow-but-steady growth it enjoyed up until the late 1990s, but its broader impact has been to expand the total base of multichannel TV homes."[7]

The Government Accountability Office (GAO) testified in 2005 that "DBS penetration rates have been and remain highest in rural areas, but since 2001, DBS penetration has grown most rapidly in urban and suburban areas, where the penetration rates were originally low... In short, over the 2001 to 2004 time frame, the DBS penetration rate grew about 50 percent and 32 percent in urban and suburban areas, respectively, compared with a growth rate of 15 percent in rural areas."[8] As the following chart shows, DTH penetration of television households, as of August 2005, exceeded 30 percent in 10 states, 20 percent in 37 states, and 15 percent in 46 states.

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4 "Further to Fly; DirecTV Continues to Grab Market Share Despite Stepped Up Competition," Multichannel News, May 23, 2005; "EchoStar Swings Into the Black Amid Strong Subscriber Growth," The Wall Street Journal, May 6, 2005.

5 "Cable's Unique Market Opportunity," Investment Dealers Digest, February 21, 2005.

6 NCTA estimates based on data from Kagan Research LLC.

7 "US Multichannel TV Update: Satellite Gains, But Does Cable Lose?" Strategy Analytics, Inc., April 1, 2005.

8 Statement by Mark L. Goldstein, Director, Physical Infrastructure Issues, Government Accountability Office, Congressional Quarterly, GAO Report, April 2005 at 3.

States with Direct-To-Home (DTH) Dish Penetration of Fifteen Percent or More (August 2005)

State	Penetration Rate	State	Penetration Rate
Vermont	41.59%	Arizona	25.09%
Utah	38.08%	South Carolina	25.01%
Montana	37.91%	Oregon	24.84%
Idaho	36.90%	Wisconsin	24.10%
Wyoming	35.49%	South Dakota	23.40%
Mississippi	33.59%	North Dakota	23.31%
Missouri	33.52%	Illinois	23.09%
Arkansas	32.08%	Alaska	22.70%
Georgia	30.75%	Nebraska	22.59%
Colorado	30.09%	Washington	22.54%
Oklahoma	29.17%	Maine	22.40%
New Mexico	29.13%	Michigan	22.25%
Alabama	27.40%	Florida	21.97%
Indiana	27.18%	Kansas	21.97%
Iowa	26.92%	Ohio	18.34%
California	26.67%	Nevada	18.29%
Tennessee	26.39%	Louisiana	18.27%
Virginia	26.08%	Maryland	17.79%
North Carolina	26.04%	Delaware	17.56%
Texas	26.03%	New York	16.57%
West Virginia	25.88%	New Hampshire	16.50%
Kentucky	25.82%	New Jersey	15.57%
Minnesota	25.31%	Pennsylvania	15.16%

Source: SkyTRENDS SkyMAP, August 2005; www.skyreport.com; TV Household data from A.C. Nielsen.

In order to respond to the competition posed by DBS, cable has invested $100 billion in new equipment and facilities since passage of the Telecommunications Act of 1996 (Appendix A provides details on cable's investment and deployment of new services and technology). As a direct result of DBS's numerous channels and all-digital technology, cable has invested heavily in new digital services and introduced digital tiers – including HDTV, interactive program guides, video-on-demand, personal video recorders, and CD quality, commercial-free music channels.

Cable's upgrades have provoked a competitive response from DBS, which is good for consumers. For example, DirecTV's CEO Chase Carey acknowledges that many cable operators have improved their video service in recent years, "which is why we have to continue to improve."[9] In an effort to keep pace with cable's video-on-demand movie offerings, DirecTV and EchoStar have stepped up marketing and promotion of their pay-per-view movie services.[10] In addition to EchoStar's stand-alone pay-per-view channels, the company's Dish on Demand service launched January 2005 with 30 titles downloaded to subscribers using the company's DISHPlayer Digital Video Recorder (DVR). DirecTV has promoted its pay-per-view business with discounts on recent Hollywood releases. EchoStar is rolling out the first portable DVR device, called the Pocket-Dish, in an effort "to get a leg up in its battle with cable and satellite TV rivals."[11] EchoStar is also purchasing Cablevision's satellite assets.[12] It has also teamed up with Frontier, a telecommunications provider, to offer a bundled package of satellite television, Internet and telephone service in 24 states.[13] This is in addition to the joint marketing arrangements DirecTV and EchoStar have with Bell companies.

Broadband Service Providers and Municipal Overbuilders

Although DirecTV and EchoStar are cable's largest MVPD competitors at this time, cable operators continue to face competition from other facilities-based providers in major U.S. markets. Broadband service providers (BSPs) – which include independent, municipal, and CLEC overbuilders – are offering bundles of video, voice, and data services over a single

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9 "Further to Fly; DirecTV Continues to Grab Market Share Despite Stepped Up Competition," Multichannel News, May 23, 2005.
10 "DBS Tries PPV Discounts, Downloads," Multichannel News, May 23, 2005.
11 "EchoStar to Roll Out Portable DVR Device," Investor's Business Daily, May 26, 2005.
12 "EchoStar to proceed with satellite deal," Financial Times, March 31, 2005.
13 "Frontier, EchoStar Form Strategic Alliance," Satellite News, April 5, 2005

network.[14] RCN, the largest BSP, has 371,000 cable subscribers and ranks as the twelfth largest MSO. It operates in major metropolitan areas, including San Francisco, Chicago, Boston, New York, and Washington, D.C. RCN's video, telephone, and high speed data service passes nearly 1.5 million homes.[15]

Wide Open West (WOW), the fourteenth largest MSO, serves an estimated 292,500 subscribers, and passes an estimated 1.4 million homes.[16] Knology Holdings, the twenty-first largest MSO, reports 179,800 cable subscribers, and passes 780,000 subscribers.[17] Grande Communications, the thirtieth largest MSO, provides cable service to 85,400 subscribers and passes more than 325,000 homes.[18]

Municipally-owned cable systems, in selected areas, also continue to compete with cable systems and other MVPDs. According to a survey by the American Public Power Association (APPA) of its members, conducted at the end of 2004, 102 municipally-owned utilities offered cable TV service.[19] The APPA survey also reported that 81 municipally-owned utilities were offering cable modem or DSL service, and 52 municipal utilities offered telephone service.[20]

Mobile Video

In just the last year, video programming distributors have introduced video over wireless phones and other portable devices. Verizon Wireless rolled out V Cast, a service that offers

14 11th Annual Report at 2801, n. 362.
15 "Cable TV Investor: Deals and Finance," Kagan Research, Inc., August 25, 2005, at 11.
16 Id.
17 Id.
18 Id.
19 "Powering the 21st Century Through Community Broadband Services," American Public Power Association, Sept. 2005.
20 Id.

video programming to cellular telephone users, in February 2005.[21] V Cast currently provides news updates, sports highlights, celebrity news, stock quotes and market information, weather, and games for $15 per month. Its television-like video, at high bit rates, allows customers to download music videos and other high quality content. It is also reportedly working on its own original, reality programming.

Sprint Corporation began broadcasting live video over its wireless phones in August 2004.[22] Sprint PCS customers can now see news, video clips, and other content real time over their cell phone. MobiTV, a video service available to Sprint PCS, Cingular, and several regional carriers' customers, sends programs to cell phones and currently has 300,000 subscribers. Qualcomm recently introduced its TV-cell phone service, MediaFlo.[23]

The drive to deliver TV content to portable devices is picking up steam, as some providers prepare to launch Hollywood films and short format cinema in the near term.[24] HBO and Cingular Wireless are reportedly considering a wireless content distribution arrangement.[25] In addition to making the network's existing programming available, HBO may create new entertainment channels for the service.

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21 "On-Demand In The Palm Of Your Hand: Verizon Wireless Launches 'VCAST' – Nation's First And Only Consumer 3G Multimedia Service," Verizon press release, January 7, 2005.

22 "Sprint Will Start TV Service for Wireless," Kansas City Business Journal, August 13, 2004.

23 "Qualcomm Goes with the MediaFLO; Armed with New Chip, company to join the TV-cell phone scramble," Broadcasting & Cable, May 16, 2005.

24 "The Movie Theater in Your Pocket; Direct from Cellywood: Cell-phone cinema isn't exactly like the bit screen kind, but its potential sure is attracting attention," Business Week Online, June 22, 2005.

25 "HBO Unplugged," MSNBC.com, August 9, 2005.

Meanwhile, Sony's new portable PlayStation game device, known as PSP, is another mobile video play. It is capable of downloading TV shows and video information. It has been called "a plasma screen in your pocket."[26]

Cable operators are beginning to add wireless options to their bundle of services. Time Warner Cable, for example, began testing cell phone service in partnership with Sprint in Kansas City.[27]

Digital video recorders and video-on-demand services have fueled consumer awareness and appetite for the technology for watching TV shows *whenever* you like. It seems inevitable that video providers would offer the ability to watch TV *wherever* you like. Although still a nascent service, one survey predicts that about 125 million consumers will be watching mobile television on their wireless phone in five years.[28]

Internet Video

The video landscape is marked not only by intense rivalry among cable, satellite and telephone providers but also Internet-based video delivery systems. Consumers now have new ways to access video content – from digital cell phones and other portable devices to interactive websites to enhanced in-home consumer electronics and computer equipment with high definition DVD or streaming video-capability. Not surprisingly, Internet companies such as Yahoo and Google have declared themselves to be media companies offering multiple services to compete with cable.

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26 "The Handy Future of TV: With Internet Uploads to Portable Players, the Airwaves are Wide Open," Kansas City Star, April 20, 2005.
27 "Bells' Bundles undercut cable TV operators," Atlanta Constitution, April 8, 2005.
28 "TV for Mobile Phones Set to Reach Masses," ExtremeTech.com, May 3, 2005.

As one observer put it, the ethos of New TV can be captured in a single sweeping mantra: *anything you want to see, any time, on any device*."[29] Another stated it this way:

> It's the key battleground in what promises to be one of the most bruising – and important- global corporate fights in the next couple of years. Telephone giants, cable titans, computer companies and consumer electronics makers are all vying to provide the next generation of high-tech entertainment – a single network or gadgets that lets you view photos, listen to music, record DVDs and tune into whatever TV programs you want to watch, whenever you feel like watching them.[30]

There is no denying that this proliferation of new delivery modes – the combination of digital communications and computers with entertainment and immediate access to worldwide information – is making all industry players compete more aggressively to stay in the game. As one media analyst recently said, "from an investment standpoint, I don't think we've ever before seen such a competitive landscape."[31]

The FCC has recognized that video provided over the Internet has grown and promises to become an increasingly strong participant in the video programming marketplace.[32] Growing consumer demand for compelling content on the Internet combined with a burgeoning variety of broadband platforms is spurring this growth. As broadband Internet offers broadcast-quality video, consumers are increasingly turning to Internet-based means of accessing video content, including downloading movies and other high value video content traditionally available only through broadcast, cable, satellite or home video outlets. Libraries of video content, containing *thousands* of hours of video programming, are becoming available to consumers on a personalized, customized basis.

[29] "Television Reloaded," Newsweek, May 30, 2005.
[30] "Who's going to win the living room wars?", The Wall Street Journal, April 25, 2005.
[31] "Panelists See Communications Services Converging," Communications Daily, June 2, 2005, quoting Richard Greenfield of Fulcrum Global Partners. See also, "Who's going to win the living room wars?", The Wall Street Journal, April 25, 2005.
[32] 11th Annual Report at 2762.

Internet companies are providing their own unique content or partnering with other established content providers and video distributors. New entrants, like Akimbo Systems, offer a mix of established TV programming and unique content via the Web. Akimbo charges $10 a month and offers about 1600 programs, some for an extra fee. The company's chief executive predicts that Akimbo "will do what eBay has done for retailing."[33] Google, Yahoo! and Microsoft are developing video search engines to harness video content via their portal service.[34] Over the past year, Yahoo! predicted a one billion subscriber base for its multiple media services by decade's end.[35] BitTorrent, an Internet file-sharing method enables video enthusiasts to trade video files online. iFilm and other websites offer video clips to millions of customers. Wi-FiTV, a broadband Web site that features more than 200 TV channels from around the world, recently began service.

Program networks are enhancing their Internet presence to gain viewers and advertising dollars. These web "channels" contain specially made programming, short videos targeting niche interests, and repackaged TV content.[36] MTV Overdrive, a mix of news, live performances and on-demand music videos launched in April. Networks such as Home & Garden Television, Food Network, CNN, Fox News Channel, and MSNBC are offering more video content on their sites. According to one analyst, Internet advertising is headed toward a 25 percent increase over the last year, to upwards of $8.8 billion in 2005.[37]

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33 "Merger of TV and Web May Hit Cable Industry Before It's Prepared," The Wall Street Journal, April 18, 2005.
34 "Next Via the Internet: Tailored TV," Associated Press Online, May 16, 2005.
35 "Mermigas on Media," The Hollywood Reporter, April 5, 2005.
36 See e.g., "CNN.com plans Internet live news service," Financial Times, May 16, 2005.
37 WSJ On-Line, May 16, 2005.

AOL saw a jump of 120 percent in its on-demand video streaming in 2004 and drew in five million viewers for its exclusive live coverage of the July 2, 2005, Live 8 concert.[38] ManiaTV.com, the interactive television website, had 1.6 million users in July alone.

As Internet companies and website operators grow their video on-line businesses, consumer electronics manufacturers are developing ways to exploit the World Wide Web via equipment. Toshiba and Matsushita, for example, offer digital TVs that allow users to download and store online video, along with DVD recording capability.[39] PC makers are developing new "media center" PCs that can play and record movies, television and music accessed on-line. As described by PC magazine online, "there is going to be a big battle for dominance in people's living rooms. What we've seen is a mini-explosion of set top boxes for Internet television."[40] This flurry of announcements and deals in recent months shows that all players in the video marketplace are positioning themselves to compete in the IPTV arena.

Broadcasting

Broadcasters are still formidable competitors to cable and other multichannel providers. The competition for viewers is manifested in the battle for advertising dollars. After a 10-year decline in viewers aged 18 to 49, the broadcast networks posted an increase in this key demographic for the 2004-2005 television season. It all came down to the big four broadcast networks' crop of breakout hit shows. Some network shows turned in performances "akin to the

[38] "Extreme TV; ManiaTV.com offers college kids a broadband barrage of chat, sport, music and film. Is this the perfect media for the digital generation?" MSNBC.com, August 24, 2005.

[39] "Format Wars," Financial Times, Comment & Analysis, March 3, 2005.

[40] "The Web: Internet TV Ready for Prime Time," Gene Koporwski, UPI, March 9, 2005.

days before cable became a serious competitor."[41] This has boosted advertising commitments for the coming year on all broadcast networks.

While the broadcast share of television viewing has declined in recent years as television viewers have increasingly opted for the multitude of choices available on cable, broadcast television remains a potent force. Broadcasting's share of the viewing day continues to exceed 40 percent.[42] Moreover, approximately 15 percent of television households do not subscribe to any multichannel service. These television households continue to find broadcast television alone or in combination with non-MVPD video sources (such as DVDs) to be their preferred means of receiving video programming – and a significant percentage of MVPD households include television sets that are not connected to multichannel service.

Home Video

In the heated battle for consumers' time and entertainment dollars, DVDs, video cassettes and laser discs continue to provide competitive alternatives to MVPD viewing options. There are approximately 47,000 DVD titles available for purchase or rental today, compared to 30,000 a year ago.[43] Consumers spent $24.5 billion renting or purchasing DVD and VHS last year, while generating $9.4 billion in domestic box office revenue.[44] In addition to theatrical releases, many highly popular previously broadcast television series are now available in DVD format,

41 "Desperate No More? Networks See a Rebound in Viewers," The Wall Street Journal, May 26, 2005.

42 Cabletelevision Advertising Bureau, 2005 Cable TV Facts, www.onetvworld.org/?modula-displaystory+story_id=1257xformat=html.

43 The Digital Entertainment Group, "DVD Household Penetration reaches 75 Million," (press release), July 26, 2005.

44 The Digital Entertainment Group, "Industry Boosted by $21.2 Billion in Annual DVD Sales and Rentals," (press release), January 6, 2005; "Movie Income Rises in 2004, but Ticket Numbers Sag Slightly," The Associated Press, January 5, 2005 at http://www.post-gazeette.com/pg05005/437134.stm.

frequently accompanied by major advertising campaigns. Popular cable network shows are also available on DVD.

The growth in sales of DVD-formatted programming has been facilitated by gains in the sale of DVD hardware. U.S. consumers purchased 37 million DVD players in 2004, an eight percent increase over the previous year. During the first half of 2005, nearly 14 million DVD players were sold to consumers, more than a six percent increase over the same period last year. Household penetration is expected to reach 80 percent by year-end 2005, with over 45 percent of DVD owners having more than one player.[45] When accounting for computers with DVD-ROM drives and DVD-enabled video game consoles, an estimated 79 million households currently have the capability to play DVD, approaching three-fourths of all U.S. TV households.[46]

With regard to DVD software, on-line provider Netflix recently teamed with retail giant, Wal-Mart, to offer their customers access to more than 40,000 titles of video programming.[47] Overall, consumers spent $15.5 billion in 2004 on DVD sales, an increase of 33 percent over 2003, while revenues from DVD rentals increased 26 percent over 2003, as consumers spent more than $5.7 billion.[48]

III. TELEPHONE COMPANY ENTRY INTO VIDEO

Now that DBS has transformed the video marketplace so that virtually all television households have choice, it is easy to forget that only a decade ago, it was the large local telephone companies that were promising to provide a competitive alternative to cable – just as cable operators were promising to provide a competitive alternative to the telephone companies.

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45 Id.
46 Id.
47 "Walmart.com and Netflix Announce New Promotional Agreement," Press Release, May 19, 2005.

Congress took these promises seriously. The Telecommunications Act of 1996, by removing barriers to the telephone companies' entry into cable[49] and cable's entry into the provision of local exchange service,[50] was intended to promote the convergence of voice, video, and data services in a competitive marketplace.

The cable industry took its promise seriously, too. Over the last decade, cable operators have invested $100 billion to upgrade their facilities. In addition to providing a wealth of new video programming alternatives – including digital tiers, video-on-demand, and high definition television – cable now offers robust high-speed Internet service and telephone service. Meanwhile, during most of that period, the telephone companies' promises to enter the video marketplace went unfulfilled.

Now, however, the telephone companies are reviving their plans to provide multichannel video programming services. Telephone companies are not only touting their proposed video offerings but are actively deploying facilities and beginning to make video service available.[51] For example, SBC is spending $4 billion over the next three years to install fiber optic cable to serve up to 18 million homes and plans to deliver television services using Internet protocol (IP) technology.[52] Verizon is spending $6 billion over five years to lay fiber direct to the home to reach up to 16 million households in its service areas.[53]

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48 Id.

49 See generally Section 302 of the Telecommunications Act establishing new sections 651-653 of the Communications Act, 47 U.S.C. §§ 571-573.

50 See Section 303 of the Telecommunications Act, establishing Section 621(b)(3) of the Act, 48 U.S.C. § 541(b)(3), to facilitate cable provisions of telecommunications services.

51 "SBC Communications to Detail Plans for New IP-Based Advanced Television, Data and Voice Network," SBC Press Release, Nov. 11, 2004; "Verizon's New High-Fiber 'Diet' for New Jersey, Blazing Fast Data, Crystal Clear Voice, Video Capability," Verizon Press Release, Sept. 15, 2005.

52 "SBC and Comcast Want it All," San Francisco Chronicle, July 31, 2005.

53 "Verizon, DirecTV Get Closer," Boston Globe, February 22, 2005.

Although there is already vigorous competition in the video marketplace, the prospect of a major new competitor with the resources of the Bell Operating Companies should be beneficial to consumers – as long as competition is governed by marketplace forces and is not artificially skewed by rules and regulations that unfairly give some competitors an unfair advantage over others. (As noted above, these "new entrants" have annual revenues of $150 billion – about three times those of "incumbent" cable operators.) The marketplace will impel competitors – old and new – to innovate in the development of new services and in the packaging and pricing of their offerings to maximize value to consumers.

IV. LIKE SERVICES SHOULD BE TREATED ALIKE

To the extent that telephone companies intend to offer many of the broadcast signals and cable program networks currently available to cable subscribers, there is a comprehensive federal regulatory framework already in place – Title VI of the Communications Act – to govern their video activities. Some telephone companies argue, however, that they should not be subject to the same regulatory framework as other cable operators. They maintain that compliance with the obligations and requirements of Title VI would impede their ability to compete as quickly as possible in the video marketplace.

It is not unreasonable to consider, from time to time, whether existing regulations and requirements continue to serve important governmental purposes – for *all* competitors subject to those regulations. For example, *economic* regulations (such as rate regulation) that are imposed on entities presumed to have market power may serve no purpose if that market power has been eroded by marketplace competition. Other regulations may have nothing to do with market power and may, in the case of Title VI, represent a consensus of policymakers regarding the social obligations that should apply to all providers of video programming because of the unique

role and importance of television in our society. In those cases, it is reasonable to reconsider whether the social obligations continue to make sense and whether the particular requirements and obligations are necessary, in a competitive environment, to ensure that such obligations are met.[54]

If those obligations and responsibilities do continue to make sense, they should be shared by all competing providers of like services. If not, then there is no basis for imposing them on any of the competitors. To arbitrarily subject some competitors to obligations and burdens not imposed on others would only serve to distort the competitive marketplace.

Congress included in Title VI a self-correcting mechanism that removes the burdens of economic regulation from cable operators that face "effective competition."[55] Rate regulation, uniform pricing, "buy-through" restrictions and other provisions in Section 623 of the Act do not apply to new entrants, including telephone companies, because those competitors face "effective competition" from the existing cable operators as soon as they enter the marketplace.

In addition, Congress amended Title VI in 1992 to bar *exclusive* cable franchises and to prohibit franchising authorities from unreasonably refusing to grant additional competitive

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[54] With respect to the entry of new IP-based competitors in the provision of telephone service, NCTA has advocated a similar approach of eliminating unnecessary economic regulation of providers facing competition while maintaining those regulations that are still deemed to embody important social responsibilities of all telco providers: NCTA, "Balancing Responsibilities and Rights: A Regulatory Model for Facilities-Based VoIP Competition," http://www.ncta.com/pdf_files/whitepapers/VoIPWhitePaper.pdf?PageID=365 at 4 (2005).

> Protecting VoIP services from unnecessary regulation does not require that important public policies be neglected. Even under a generally deregulatory regime, any VoIP service that meets a baseline test as proposed herein can, and should, meet certain public policy responsibilities and requirements such as the principles set forth in the Communications Assistance for Law Enforcement Act ("CALEA"), the offering of 911/E911, access for the disabled, and appropriate contributions to universal service. But the overall direction of public policy should be toward a deregulatory environment in which even the most vital public policy objectives are secured through the lightest possible regulation, so as not to forestall the many benefits of these new services.

franchises. A telephone company or other potential new entrant whose application for such a franchise has been denied for reasons that it believes to be unreasonable may appeal such a denial in federal or state court.[56]

Therefore, the requirement that telephone companies *obtain* a franchise is not a barrier to competitive entry. If telephone companies were simply to agree to the same franchise obligations as existing cable operators, a franchising authority would be hard pressed not to grant a franchise expeditiously. What the telephone companies urge, however, is that they *not* be subject to the same social obligations and responsibilities as competing cable operators.

In particular, telephone companies object to being required, like other cable operators, to offer service throughout a community. Section 621 of the Communications Act directs franchising authorities to "assure that access to cable service is not denied to any group of potential residential cable subscribers because of the income of the residents of the local area in which such group resides."[57] In addition to this restriction on economic "redlining," most franchising authorities require cable operators to build out their facilities to serve all but the most sparsely populated areas of their communities.

Section 621 requires franchising authorities to allow franchise applicants "a reasonable period of time to become capable of providing cable service to all households in the franchise area"[58] – but this is not sufficient for the telephone companies. They claim that build-out and anti-redlining obligations are unwarranted barriers to entry that will keep them from offering their competitive services.

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55 See 47 U.S.C. § 543(a)(2).
56 See 47 U.S.C. § 541(a)(1).
57 47 U.S.C. § 541(a)(3).
58 47 U.S.C. § 541(a)(4).

It is clearly not the just the costs of construction that the telephone companies are worried about – although some areas may, in fact, be more costly to serve than others. What they have also recognized is that some areas of the community are likely to generate substantially more revenue than others, wholly apart from the costs of serving them. Thus, as SBC, for example, has explicitly told prospective investors, their objective is to serve only the "high value" areas of the community without offering service to the "low value" areas.[59]

If the telephone companies were allowed to serve only the most lucrative areas of communities that cable operators were required to serve in their entirety, competition would not be enhanced but would suffer. Consumers in the areas that the telephone companies chose not to serve would pay the highest price for such disparate regulatory treatment. Appendix B by Michael G. Baumann of Economists Incorporated explains why this would be the case.

The effect of a mandatory build-out requirement is generally to make service available to areas that would not otherwise be served – otherwise, there would be no need for the rule. To recoup and subsidize the costs of deploying facilities and serving these areas – the areas that SBC would call "low value areas" – cable operators are likely to rely on revenues from areas that cost less to serve and/or where customers purchase more options (the "high value areas"):

> With cable systems, it is often the case that there are differences in the costs of serving different geographic areas. While programming costs per subscriber do not vary by area, the per-subscriber cost of maintaining the physical plant may be higher in some areas. In addition, due to variations in household income and demand, certain geographic areas may generate larger revenues per subscriber as a result of the programming and other services purchased. The revenues from subscribers in these high value areas may be of critical importance to the cable operator in covering the costs of upgrading and expanding the entire cable system. In effect, the revenue from these areas cross-subsidizes the cost of upgrading other areas.[60]

[59] SBC, Investor Update, Lightspeed, Nov. 11, 2004, 13-14.

Cross-subsidization[61] cannot be sustained if a significant competitor is allowed to construct facilities and provide service only in the areas where costs are lowest and/or expected revenues are highest. As Baumann points out, proponents of allowing such cream-skimming by telephone companies envision a result in which "all consumers are better off because the incumbent's price is lower everywhere and some consumers have the added choice of subscribing to the entrant's service."[62] But this is not a viable outcome.

Since the telephone company will, as the result of cream skimming, have lower per-subscriber costs and higher per-subscriber revenues than the competing cable operator, it will be able to charge less than that operator – and this will likely force him to lower his price in the area served by the telephone provider. However, the operator cannot simply lower prices across the board, making everybody better off:

> Without the ability to finance the cross-subsidies needed to support the low value areas, *the incumbent's situation has to change*. The actual outcome will depend on the degree to which the incumbent's ability to subsidize the low value area is reduced and what, if any, regulatory relief is provided. While one cannot predict with certainty what will happen given the variation in conditions across franchises, *some groups of consumers, particularly those in the low value areas, will likely be harmed in the long run*.[63]

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60 M. Baumann, "The Adverse Effects of Asymmetric Build-Out Requirements in Cable Television" at 4 (see Appendix B).

61 Cross-subsidy here refers to the fact that different customers have different net costs associated with providing facilities and services. Customers residing in high density housing have lower per-mile construction costs associated with their service, for example. This type of cross-subsidy, common to all businesses with variable customer cost structures, differs from the regulatory cross-subsidy practiced by historically rate-regulated utilities like power and telephone companies and policed by regulators. This latter unlawful practice assigns costs from unregulated activities to the regulated, rate-of-return rate base, thereby easing entry into unregulated activities by regulated utilities. Build-out requirements assume that customers may have variable costs associated with serving them; nevertheless the public policy benefits of such nearly ubiquitous service outweigh the disadvantages to the provider of serving only lower-cost customers.

62 Baumann at 5.

63 Id. at 8 (emphasis added).

Facing effective competition from DBS providers and telephone companies, cable operators will no longer be subject to uniform pricing constraints. One alternative might simply be to raise prices in the higher-cost areas that the telephone companies choose not to enter. But this may not be a viable alternative. Operators may not be able to raise prices in those areas without losing more revenue than they gain – either because of competition from DBS or because customers are simply unwilling or unable to pay such higher prices for any multichannel subscription service.

In that case, as Baumann explains, allowing a significant new entrant to cream skim the "high value" areas of a community may threaten the quality – or the continued existence – of cable service in the "low value" areas that the new entrant chooses to ignore. It may even unfairly threaten the competitive viability of the cable operator throughout the community:

> The incumbent may be able to maintain, but not upgrade, the current level of service in the low value area. Alternatively, the incumbent may not be able to continue to serve all of the low value areas. Finally, the incumbent may be at such a disadvantage relative to the entrant that it will eventually exit the entire franchise area.[64]

In these circumstances, *exempting* new entrants from the build-out and anti-redlining obligations imposed on existing operators would actually pose a greater threat to fair marketplace competition than *imposing* such obligations – especially in a video marketplace in which consumers are already enjoying the benefits of vigorous competition among cable operators and two strong DBS services. Moreover, it would directly undermine President Bush's policy goal of promoting ubiquitous competitive broadband availability throughout the nation, including areas that might otherwise be underserved by 2007.[65] As Baumann points out,

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[64] Id. at 8.

[65] "This country needs a national goal for broadband technology, for the speed of broadband technology. We ought to have a universal, affordable access for broadband technology by the year 2007, and then we ought to make sure as soon as possible thereafter, consumers have got

> [i]f identical regulations are applied to both the incumbent and the entrant, whether both firms survive or only one firm survives, and which one, is left to the competitive forces of the marketplace. Admittedly, the competition in the marketplace is subject to the constraint of universal service, but in the end all potential customers will have the ability to get cable service. Alternatively, if constraints apply only to the incumbent, then which firm or firms survive is not a function solely of the competitive marketplace, but is influenced by the asymmetric enforcement of governmental regulations. And, in the end, it is possible that many fewer customers will get cable service.[66]

Mr. Chairman, one can construct an intellectually coherent argument that a desire for something akin to universal service requires a build-out requirement that is applied to all providers. One can also construct an intellectually coherent argument that universal service is no longer a social goal that trumps the free market, and therefore no build-out requirements should apply to any providers. But the one policy proposal that is illogical and counterproductive is to pretend a build-out requirement is an important goal, but then place that burden on one provider and free another to cherry pick customers: neither universal service nor free market competition is achieved in such a case.

V. CONCLUSION

As Congress takes up possible amendments to the Telecommunications Act of 1996, we urge you to treat like services alike, preferably in a deregulatory environment. We will do the rest to raise private risk capital, invest in new technology, offer better customer service, create innovative programming, compete with other multichannel video providers, and serve the needs of consumers by providing the best choices available in the market for video, voice, and data services.

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plenty of choices when it comes to purchasing the broadband carrier." Remarks by President Bush, March 26, 2004, http://www.whitehouse.gov/news/releases/2004/03/20040326-9.html.

66 Baumann at 8.